

# **TRANSCRIPT OF RECORD.**

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**SUPREME COURT OF THE UNITED STATES.**

**OCTOBER TERM, 1922.**

**No. 744.**

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**SEABOARD AIR LINE RAILWAY COMPANY, APPELLANT,**

**vs.**

**A. D. WATTS AND A. D. WATTS, AS COMMISSIONER  
OF REVENUE OF THE STATE OF NORTH CAROLINA,  
ET AL.**

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**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR  
THE EASTERN DISTRICT OF NORTH CAROLINA.**

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**FILED DECEMBER 18, 1922.**

**(29,294)**



(29,294)

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TRANSCRIPT OF RECORD.

In the District Court of the United States for the Eastern District of North Carolina.

At a District Court of the United States for the Eastern District of North Carolina begun and held at the court-house, in the city of Raleigh, on the fourth Monday after the fourth Monday in October, being the 20th day of November, in the year of our Lord one thousand nine hundred and twenty-two.

Present: The Honorable Henry G. Connor, Judge of the District Court for the Eastern District of North Carolina.

Among others were following proceedings, to-wit:

In Equity.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Individually and as Commissioner of Revenue of North Carolina, et al.

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*Bill of Complaint.*

Filed March 9th, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina; BENJAMIN R. Lacy, State Treasurer of North Carolina; Baxter Durham, State Auditor of North Carolina, and James S. Manning, Attorney General of North Carolina, Defendants.

To the Honorable H. G. Connor, Judge of the District Court of the United States for the Eastern District of North Carolina:

Seaboard Air Line Railway Company, a corporation duly organized and existing under the laws of the States of Virginia, North Carolina and South Carolina, and a citizen of the said states, brings

this, its Bill of Complaint against A. D. Watts, Commissioner of Revenue of North Carolina, a citizen of the State of North Carolina, whose official residence as Commissioner of Revenue of North Carolina is at the city of Raleigh in said state and in the Eastern District thereof, and Benjamin R. Lacy, Treasurer of the State of North Carolina and a citizen and resident of the county of Wake in the Eastern District of said state, and Baxter Durham, Auditor of the State of North Carolina, and a citizen and resident of the county of Wake in the Eastern District of said state, and James S. Manning, Attorney General of the State of North Carolina and a citizen and resident of the county of Wake in the Eastern District of said state.

And complainant respectfully represents that:

1. The complainant is now, and was at all times hereinafter mentioned, a corporation duly organized and existing under the laws of Virginia, North Carolina and South Carolina, and it now does, and did at such other times hereinafter mentioned, own, operate, manage and control lines of railroad and other property in connection therewith in and through the states of Virginia, North Carolina, South Carolina, Georgia, Florida and Alabama, and it is now, and was at all such other times, engaged in operating said lines of railroad in interstate commerce.

2. The defendant, A. D. Watts, is Commissioner of Revenue of the State of North Carolina, duly appointed by the Governor of North Carolina, and under and by virtue of Chapter 40 of the Public Laws of North Carolina of 1921, and duly qualified under the laws of said state, and is a citizen of North Carolina, whose official residence as Commissioner of Revenue is at the city of Raleigh, in said state and in the Eastern District thereof; that the defendant, Benjamin R. Lacy, is the State Treasurer of the State of North Carolina, duly elected and qualified under the laws of said state, and is a citizen and resident of the county of Wake in the Eastern District of said state; that the defendant, Baxter Durham, is the State Auditor of the State of North Carolina, and a citizen and resident of the county of Wake in the Eastern District of said state; that the defendant, James S. Manning, is Attorney General of the State of North Carolina, and a citizen and resident of the county of Wake in the Eastern District of said state. The said defendants, A. D. Watts, Benjamin R. Lacy, Baxter Durham and James S. Manning, are charged with the duty of levying, assessing and collecting the tax which the State of North Carolina asserts is due to it by the complainant. More particular reference to the tax involved in this suit will presently be made.

3. This is a suit in equity and arises under the Constitution and laws of the United States, as will presently more fully appear, and the amount in controversy, exclusive of interest and costs as will hereinafter be specifically shown, exceeds the sum and value of Three Thousand Dollars (\$3,000.00). The complainant brings this suit to restrain the defendants from levying, assessing and collecting certain taxes upon the complainant and its property

in North Carolina under color of the several statutes of North Carolina hereinafter mentioned. The complainant respectfully shows that unless the defendants and all of them be restrained from enforcing collection of said taxes, it will be deprived by privileges and immunities guaranteed and secured to it by the Constitution of the United States and the Fourteenth Amendment thereof; and further, that it will be deprived of its property without due process of law and will likewise be denied the equal protection of the law, in contravention of the Constitution of the United States and the Fourteenth Amendment thereof. The complainant also shows that the taxes sought to be imposed by virtue and under the authority of the North Carolina statutes constitute a direct burden upon interstate commerce in violation of the Commerce Clause of the Federal Constitution.

4. The complainant shows that the provisions of the Constitution of North Carolina, Article 5, Section 3, authorizing the levy of an income tax on itself and other railroad corporations are as follows:

Taxation Shall be by Uniform Rule and ad Valorem—Exemptions.—Laws shall be passed by taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and, also, all real and personal property, according to its true value in money: Provided, notes, mortgages, and all other evidence of indebtedness given in good faith for the purchase price of a home, when said purchase price does not exceed three thousand dollars, and said notes, mortgages, and other evidence of indebtedness shall be made to run for not less than five nor more than twenty years, shall be exempt from taxation of every kind; Provided, that the interest carried by such notes and mortgages shall not exceed five and one-half per cent. The general assembly may also tax trades, professions, franchises, and income: 'Provided, the rate of tax on income shall not in any case exceed six per cent (6%), and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to wit: for a married man with a wife living with him, or to a widow or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less than \$1,000, and there may be allowed other deductions (not including living expenses) so that only net incomes are taxed.'"

5. The complainant shows that the Legislature of North Carolina, at its regular session of 1921, purporting to act under the authority of the provision of the constitution above quoted, enacted a law providing for the levying, collecting and paying of an income tax on individuals and corporations, the said law forming a part of the Revenue Act of 1921, being Chapter 34 of the Public Laws of North Carolina of 1921. It is provided by Section 100 of said Revenue Act that the income tax schedule should be known and cited as the Income Tax Act of 1921, and said act will be so referred to in this bill of complaint.

6. Section 101 of the Income Tax Act of 1921, as amended by the General Assembly of North Carolina, Special Session of 1921, is as follows:

"Sec. 101. Purpose.—The general purpose of this act is to impose a tax, for the use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922, and annually thereafter:

(a) Of every citizen of the State.

(b) Of every domestic corporation.

6 (c) Of every foreign corporation and of every nonresident individual having a business or agency in this State, in proportion to the net income of such business or agency.

Except as otherwise provided in this act the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority, in so far as they apply.

The Tax imposed upon the net income of corporations in this schedule is in addition to the tax imposed under Schedule C of this Act."

7. Section 201 of the Income Tax Act of 1921, as amended by the General Assembly of North Carolina, Special Session of 1921, is as follows:

"Sec. 201. Corporations.—Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale, or rental of real estate or from the manufacture, sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

7 In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State."

8. Section 202 of the Income Tax Act of 1921 is as follows:

"Sec. 202. Railroads and Public Service Corporations.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when

such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of 'operating expenses,' or 'operating ratio,' for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue,' and taxes paid in this State for the income year other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

9. The foregoing section relating to the basis of ascertaining the net incomes of railroads was supplemented by Chapter 35 of the Public Laws of 1921, as follows:

8 "Section 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then the said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire."

10. Section 203 of the Income Tax Act of 1921, as amended by Chapter 35, Public Laws of 1921, is as follows:

"Sec. 203. Such tax shall first be levied, collected, and paid in the year 1922, and with respect to the net income received during the calendar year 1921 and annually thereafter."

11. Section 3 of Chapter 34, Public Laws of 1921, provides:

"No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable and penal institutions, pensions for Confederate Soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

12. Complainant shows that the said Income Tax Act of 1921 is unconstitutional and void in its application to complainant and other railroads for the following reasons:

(a) For that it is not a tax on income as authorized in Article 5, Section 3, of the Constitution of North Carolina, but is in truth and in fact a tax upon operating income derived by railroad companies from interstate and intrastate commerce, and for the reason that from the operating revenue arrived at under the said law there are not allowed many of the deductions required by the standard classification of Accounts of the Interstate Commerce Commission, which Standard Classification of Accounts was promulgated by the said Interstate Commerce Commission under the provisions of the Interstate Commerce Act passed by Congress, and which are so regulated as to ascertain what is the net income of railroads engaged in interstate commerce. Complainant says that among other items which are directed to be deducted by railroads in interstate commerce from operating income, in order to arrive at net income, are the following:

- Joint Facility Rents;
- Rent for Leased Roads;
- Miscellaneous Rents;
- Miscellaneous Tax Accruals;
- Separately Operated Properties—Loss;
- Interest on Funded Debt;
- Interest on Unfunded Debt;
- Amortization of Discount on Funded Debt;
- Maintenance of Investment Organization;
- Income Transferred to Other Companies;
- Miscellaneous Income Charges;

and avers that in order to ascertain the net income of railroad companies engaged in business in interstate commerce, as complainant is, according to said Standard Classification of Accounts of the Interstate Commerce Commission, promulgated as aforesaid, it is necessary to deduct the above items.

(b) The method of arriving at net income does not result in the ascertainment of net income as the same is defined and arrived at under the Standard Classification of Accounts of the Interstate Commerce Commission, in that the Standard Classification of Accounts directs that there shall be deducted from the net operating income not only the deductions provided for in said law of North Carolina, but in addition thereto the following:

- Joint Facility Rents;
- Rent for Leased Roads;
- Miscellaneous Rents;
- Miscellaneous Tax Accruals;
- Separately Operated Properties—Loss;
- Interest on Funded Debt;
- Interest on Unfunded Debt;

Amortization of Discount on Funded Debt;  
Maintenance of Investment Organization;  
Income Transferred to Other Companies;  
Miscellaneous Income Charges.

The result is that the machinery provided for by the said statute for the ascertainment of net income does not in truth and in fact produce net income, which under Section 101 is declared to be the purpose of the said act to tax. Furthermore, the method outlined in said law for arriving at net income produces a figure which is not the true net income, but which contains in part gross income, and in so far as it does include gross income, which gross income is derived from interstate commerce, said tax is a direct burden upon interstate commerce and is void under the Commerce Clause of the Constitution of the United States.

(c) Complainant further says that the said statute is unconstitutional and void for that by Section 306 it permits corporations other than the corporations named in Section 202 to deduct:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

(a) As to individuals, wages of employees for services actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for co-partners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the co-partner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

(2) Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(3) All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

(4) Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

(5) Dividends from stock in any corporation, the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed



under this act only a corresponding part of the dividends received therefrom shall be deducted.

(6) Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

(7) Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

(8) A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deduc-

12 tions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the case of property acquired prior to January 1st, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases, the deductions allowed may be equitably apportioned between the lessor and lessee.

(9) In the case of taxpayers who keep regular books of account upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

(10) Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum on the taxpayer's net income as computed without the benefit of this subdivision.

(11) Resident individuals having an established business in another state, or investment in property in another state, may deduct the net income from such business or investment, if such business or investment is in a state that levies a tax upon such net income. The deduction authorized by this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

13 (12) In the case of a nonresident individual, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources

within the state; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the state shall be determined under rules and regulations prescribed by the State Tax Commission.

13. The said Income Tax Act of 1921, in violation of the Constitution of North Carolina and the Constitution of the United States, creates a discrimination against complainant and other railroad companies of similar character in favor of other corporations and individuals in that the said act in order to ascertain the taxable income allows other corporations and individuals certain deductions, many of which said deductions are not allowed to complainant and other railroad corporations of similar character.

14. Complainant shows that under the provisions of the Income Tax Act of 1921, and particularly Section 202, Section 300, and Section 306, all corporations except railroads and public service corporations which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, are required to pay a tax on their net income, which is defined by Section 300 as "the gross income of a taxpayer, less the deductions allowed by this act," whereas complainant and other railroads and public service corporations which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, are not allowed the deductions set forth in the said act, except, "uncollectible revenue" and taxes paid in the State for the income year other than income taxes, war profits and excess profits taxes, and certain deductions for car hire, and complainant shows that it and other railroad companies and public service corporations of similar character referred to in Section 202 of the

Income Tax Act of 1921 are denied large deductions which  
14 are granted other corporations, individuals and railroads not included in the provisions of Section 202, and particularly the deduction of interest paid during the income year, which results in discrimination against the complainant, in violation of the Constitution of North Carolina, and denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

15. Complainant shows that the said Income Tax Act of 1921 does not operate equally and uniformly upon all taxpayers in similar circumstances, and that the complainant and other railroads and public services corporations, which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, have been arbitrarily selected and taxed upon a more burdensome basis and one that is different from that applied to corporations in general and to other corporations engaged in business similar to that of complainant in violation of the Constitution of North Carolina and complainant is thereby denied the equal protection of the law and is deprived of its property without due process

of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

16. Complainant shows that the income tax levied by the said Income Tax Act of 1921 is not levied by a uniform rule as required by the Constitution of North Carolina, Article 5, Section 3, and the lack of uniformity works greatly to the detriment of complainant in violation of said Article 5, Section 3, of the Constitution of North Carolina and denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

17. Complainant shows that the classification of taxpayers for the purpose of fixing the income on which the tax shall be paid as made by the said Income Tax Act of 1921 is not based upon any reasonable ground, but is a mere arbitrary selection so far as complainant and railroad companies of similar character are concerned and so far as the corporations set forth in Section 202 are concerned, and was made for the purpose and has the result of imposing upon such railroad companies and corporations, including complainant, an unjust burden of taxation, in violation of the Constitution of North Carolina, and denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

18. Complainant shows that the method of fixing its taxable income as provided by Section 202 of the said Income Tax Act of 1921 violates the Constitution of North Carolina and the Constitution of the United States, because it does not apply to railroads and public service corporations which derive their income from sources other than the operation of their property, which results in a lack of uniformity in the application of the income tax and in discrimination against complainant, and therein denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

19. Complainant shows that the tax imposed upon complainant by Section 202 of the Income Tax Act of 1921 is unconstitutional and void because the authority of the Legislature of North Carolina to tax incomes is derived from Section 3, Article 5, of the Constitution of North Carolina, and said section provides that only net incomes may be taxed, and in attempting to tax the "operating revenues" of complainant, the said act violates the Constitution of North Carolina and denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

20. Complainant further shows that the statute is violative of Article 5, Section 3, of the Constitution of North Carolina, for that

does not levy upon railroads and other public service corporations named in said Section 202, a tax on net income, but levies a tax upon operating revenue derived from interstate and intrastate commerce, and does not permit the deductions necessary and incidental to the business of complainant and expended by it from said income in order to determine net income, and is in violation of the Interstate Commerce Clause (Section 8, Article 1) of the Constitution of the United States, in that it permits a tax as an income tax to be placed on gross income derived from interstate commerce, thereby burdening interstate commerce.

21. Complainant shows that the income tax act of 1921 violates the Transportation Act of Congress and the Interstate Commerce Act, in that it seeks to prescribe a method of accounting by this interstate carrier, when said Acts of Congress have delegated the power to prescribe said accounting to the Interstate Commerce Commission and the said Commission has prescribed and directed that this plaintiff and other interstate carriers keep their accounts in accordance with the methods so prescribed by it.

22. Complainant shows that the State of North Carolina, by its tax laws, permits the counties, cities, towns, townships and special taxing districts to levy taxes on the assessed value of complainant's property known as an ad valorem tax, which is based upon the whole property of complainant, tangible and intangible, and to this the tax laws of the State add a so-called franchise tax of one-tenth of one per cent on the same assessed value, and by the statutes hereinbefore referred to, the Legislature of North Carolina has levied, and unless restrained the defendants in this action will undertake to collect an additional tax characterized as an income tax of three per cent on complainant's net operating revenue, including revenue derived from interstate commerce, and complainant avers that this system of pyramiding taxes and the entire scheme of taxation amounts to a regulation of commerce between the states, because necessarily a tax of one-tenth of one per cent upon the tangible and intangible property of this complainant and a tax of three per cent upon its net operating revenue, including revenue derived from interstate commerce, are taxes upon interstate commerce, the property, tangible and intangible, having already been taxed at its full value, and complainant shows that this scheme of taxation levies a tax and burden upon the interstate commerce of complainant and violates the Commerce Clause of the Constitution of the United States, Section 8 of Article 1.

23. The complainant further shows that the statutes imposing an income tax upon complainant are unconstitutional and void in that they are violative of the scheme of taxation created and made mandatory by the Constitution of North Carolina. That instrument provides a dual system of taxation, one set of taxes being leviable by the State and the other by the counties, and other governmental subdivisions. The complainant, therefore, avers that the scheme of taxation brought about by the tax laws of the State of North Carolina by which

the State derives its entire revenue from taxes other than a tax on property is unwarranted by the Constitution of North Carolina, which by its mandate requires that all property shall bear its just proportion of the burden of taxation and that laws shall be passed taxing by uniform rule all moneys, credits, investments in bonds, stocks, joint stock companies or otherwise, and also all real and personal property according to its true value in money, (Article 5, Section 1) and the complainant shows that the North Carolina Legislature has no power to exempt a large class of property from liability to taxation for state purposes as is done by Section 3, Chapter 34 of the Public Laws of 1921, and recoup the loss of revenue thereby occasioned by taxes other than a tax on property. Such method

18 or scheme of taxation is plainly at variance with that established by the Constitution of North Carolina, and consequently Section 202, which attempts to impose a part of this additional burden of taxation upon the complainant, is void, in that it violates the Constitution of North Carolina and denies the complainant the equal protection of the laws and deprives the complainant of its property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States, and complainant further shows that the said scheme of taxation is unconstitutional and void in that the complainant is charged with an undue proportion of the expenses of the state government and a greater proportion of the burden of taxation than is warranted by the Constitution of North Carolina in that Complainant is required by the tax laws of North Carolina to pay to counties, cities and towns and special tax districts large sums as taxes on the assessed value of its property and in addition thereto a so-called franchise tax of one-tenth of one per cent on its assessed value of \$34,768,440.00 and an income tax of three per cent on its net operating revenue.

24. Complainant further shows that said tax for the calendar year 1921 is unconstitutional and void because it is retroactive to the extent that it attempts to tax income for the months of January, February and eight days in the month of March, 1921, the said act having been ratified March 8th, 1921, and being effective from the date after its ratification.

25. Complainant shows that a form for the income tax returns for the calendar year ending December 31st, 1921, copy of which is attached hereto as part of this bill of complaint, has been received by complainant which requires said return to be made in conformity with the provisions of Section 202 of the Income Tax Act of 1921 and complainant is required by law to file said return with the Commissioner of Revenue on or before March 15th, 1922, and said return will show \$437,769.52 as the amount on which complainant

19 will be taxed at the rate of three per cent, whereas, if complainant were allowed the deductions to which it is entitled it would not have any taxable income because the sum of such deductions is greater than the taxable income shown on the said return and the tax which complainant will be called on to pay to the State of North Carolina on or after March 15th, 1922, is \$13,133.09,

unless the defendants are restrained and enjoined from doing so, they will proceed on or after March 15th, 1922, to assess said tax and collect same from complainant. It is further shown that under the laws of North Carolina the said tax will become a lien upon the property of complainant and will be a cloud upon its title, and the enforcement of said tax by execution would interfere with the conduct of complainant's business as an interstate carrier, and it is further shown that, upon the collection of said tax, the amount thereof will pass into the Treasury of the State of North Carolina, and complainant is without remedy by which it can obtain refund thereof, all to the irreparable damage of complainant, and for which it has no adequate remedy at law.

26. The complainant shows that Section 600 of the said Income Tax Act of 1921 imposes certain penalties upon a taxpayer who fails to pay the taxes levied by the said act, such penalties being among other things double the amount of the tax. The complainant avers that such penalties are excessive, unreasonable, oppressive and inequitable and that it is a denial of due process of law for the said act to impose such penalties upon the complainant, who is proceeding with reasonable diligence to have it judicially determined whether or not the said Act is valid, the complainant in good faith asserting that said act is not valid. The complainant therefore avers that even though the said Act should finally be declared valid the said penalties ought not to be imposed upon the complainant.

### *Prayer.*

Wherefore, and for as much as complainant is remediless in the premises, according to the common law, and remediable only in equity, and that complainant may not suffer irreparable injury and damage, and may be permitted to pursue and carry on its business without unlawful hindrance and destruction, and that the railroads by complainant operated in the State of North Carolina as aforesaid and its other property herein may not be subjected to illegal liens and clouds, complainant prays for a writ of subpoena to issue against the defendants and each and every one of them and described as aforesaid, to appear and full and true answer make to this bill of complaint, but not under oath, answer under oath being waived, and that said defendants, and each and every one of them, be enjoined by final decree, and, meanwhile, by a preliminary injunction as follows, to-wit:

That said A. D. Watts, Commissioner of Revenue of North Carolina, be enjoined and restrained from taking, or causing to be taken, any action towards enforcing the tax, or any part thereof, which the said Income Tax Act of 1921 imposes upon the complainant or its property in the State of North Carolina.

That Baxter Durham, as Auditor of North Carolina, be enjoined and restrained from charging to complainant for collection and that Benjamin R. Lacy, as State Treasurer, be enjoined and restrained from collecting from complainant the tax or any part thereof imposed by said act.

That James S. Manning, as Attorney General of North Carolina be enjoined and restrained from instituting or authorizing the institution of any suit or proceedings to collect the said tax.

Complainant further prays that the tax statutes of North Carolina herein alleged to be unlawful be decreed by this Court to be unconstitutional and invalid, and that no assessment for taxation be made against the complainant thereunder, and no tax be levied against the complainant thereunder, and that no penalties be inflicted upon the complainant under the said Act, and for all such other, further, general and special relief which in equity it may be entitled.

This is the first application for injunction in this cause.

MURRAY ALLEN,  
*Solicitor for Complainant*

FORNEY JOHNSTON,  
JAMES F. WRIGHT,  
*Of Counsel.*

STATE OF VIRGINIA,  
*City of Portsmouth:*

J. S. Hamilton, being duly sworn, deposes and says that he is an officer of Seaboard Air Line Railway Company, to-wit: Assistant Comptroller; that he has read the foregoing bill of complaint and knows the contents thereof; that the same is true of his own knowledge, except as to matters therein stated on information and belief and as to these matters he believes it to be true.

J. S. HAMILTON,  
*Assistant Comptroller.*

Subscribed and sworn to before me this 8th day of March, 1924.

JNO. H. BOATWRIGHT,  
*Notary Public.*

I hereby certify that this is a case in which, by the laws of Virginia, no tax is required upon the seal.

JNO. H. BOATWRIGHT,  
*Notary Public.*

My commission expires 9th day of February, 1924.



## EXHIBIT "A" TO BILL OF COMPLAINT.

## Exhibit.

State Department of Revenue.

*Public Service Corporation Income Tax Return.*

(Railroads.)

For Calendar Year Ending December 31, 1921.

Name, ———.

Business address, ———.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

\_\_\_\_\_,  
President.\_\_\_\_\_,  
Treasurer.

Sworn to and subscribe before me, this — day of —, 1922.

\_\_\_\_\_,  
(Official capacity.)

*Net operating income (when business is wholly within the State).....	\$.....
*Net operating revenue, including equal mileage proportion within this State of the interstate business (when business is in part within and in part without the State).....	.....
*Other income.....	.....
Total income.....	\$.....
*Operating expenses (when business is wholly within the State).....	.....
*Proportionate average of operating expenses (when business is in part within and in part without the State).....	.....
*Uncollectible revenue.....	.....
Taxes paid in this State, other than income and war profits and excess profits taxes.....	.....
Total deductions.....	\$.....
Operating income, less deductions.....	\$.....

\*As per standard Classification of Accounts of Interstate Commerce Commission.

Plus or Minus any credit or debit balance received or paid on account of car hire. And when any railroad is partly within and partly without the State then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid.....

\$.....

Net taxable income.....

\$.....

Tax @ 3%.....

\$.....

Main track mileage (system).....

Main track mileage (State).....

## 23

Railroads and Public-service Corporations; Basis of Ascertain-  
taining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounts of the Interstate Commerce Commission, shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard classification of accounts, when the business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From that net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

24

*Application for Interlocutory Injunction.*

Filed March 9, 1922.

In Equity.

#447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et als.

Comes the above named plaintiff and shows the Court:

That it has instituted in this Court by bill of complaint an action against A. D. Watts, as Commissioner of Revenue of the State of North Carolina, and other defendants as shown in said bill which is now referred to and made a part of this application, the object and purpose of the action being to secure from this Honorable Court an order enjoining preliminarily and perpetually the defendants, who are tax assessing, collecting and enforcing officers, of the State of North Carolina, from collecting or instituting proceedings to collect an income tax on the net operating revenue of complainant under statutes which complainant alleges to be violative of the Constitution of North Carolina and the Constitution of the United States. The bill alleges and sets forth the grounds of unconstitutionality of the said income tax and of the Statutes of North Carolina under which said tax is assessed and under which it will be collected by the defendants named in said bill, unless restrained by this Honorable Court, all of which is more fully alleged, set out, and explained in the bill of complaint filed herein. Complainant alleges that said income tax is invalid and the statutes under which it is levied are in contravention of the Constitution of North Carolina, and the Constitution of the United States, and unless the defendants are restrained and enjoined from so doing, they will proceed on or after March 15th, 1922, to levy and collect said tax.

Wherefore, application is made under Section 266 of the Judicial Code for an interlocutory injunction as prayed for in said bill, and this Court is petitioned to call to his assistance to hear and determine this application two other judges, and that the statutory notice of the hearing of this application be given the Governor and the Attorney General of the State of North Carolina and each of the defendants to the said bill, and an order issued requiring the defendants to show cause at the time and place to be fixed by this Court according to law why said interlocutory injunction should not issue as prayed for.

This application is based upon the verified bill of complaint on file herein.

MURRAY ALLEN,  
*Solicitor for Complainant.*

26 *Order on Application for Interlocutory Injunction.*

Filed March 9th, 1922.

In the District Court of the United States for the Eastern District of  
North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.

The application for an interlocutory injunction was presented to me this 9th day of March, 1922, and having read and considered the verified bill filed in this cause, and the application for interlocutory injunction under Section 266 of the Judicial Code, and being advised that for the reasons set forth in said application and upon the grounds stated therein and in the verified bill, complainant is entitled to have its application heard under section 266 of the Judicial Code:

It is ordered that the application be filed and a hearing of the application for an interlocutory injunction be had and proceeded with in accordance with Section 266 of the Judicial Code as amended by Act of Congress approved March 14th, 1913, and such hearing is set down for 15th day of March, 1922, at the United States Court room in the City of Raleigh, North Carolina, at 12 o'clock M.

It is further ordered that notice of said hearing, not less than five days, shall be given to the Governor and Attorney General of the State of North Carolina and to each of the defendant-. And I hereby call to my assistance at the hearing of said application the Hon. Edmund Waddill, Circuit Judge of this Circuit, and the Hon. James E. Boyd, District Judge of the Western District of North Carolina.

This 9th day of March 1922, at Raleigh, N. C.

H. G. CONNOR,  
District Judge.

27 *Notice of Hearing of Application for Interlocutory Injunction.*

Filed March 9, 1922.

In the District Court of the United States for the Eastern District of  
North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et als.

To Honorable Cameron Morrison, Governor of the State of North Carolina; Honorable James S. Manning, Attorney General of North Carolina; Honorable A. D. Watts, Revenue Commissioner of the State of North Carolina; Honorable Baxter Durham, Auditor of the State of North Carolina, and Honorable Benjamin R. Lacy, Treasurer of the State of North Carolina:

You, and each of you, are hereby notified that the Seaboard Air Line Railway Company, complainant, has filed its verified bill of complaint in the District Court of the United States for the Eastern District of North Carolina against A. D. Watts, Revenue Commissioner, et als., praying an injunction against the named tax assessing, collecting and enforcing officers of the State of North Carolina from instituting proceedings to collect an income tax upon complainant's net operating revenue under the Income Tax Act of 1921 of North Carolina, and also praying that the laws of North Carolina levying said tax be declared unconstitutional, as will appear from the bill filed herein.

In this case plaintiff has made application for an interlocutory injunction under Section 266 of the Judicial Code of the United States.

The application for such interlocutory injunction will be heard in the United States District Court, in the City of Raleigh, North Carolina, on the 15th day of March, 1922, at 12 o'clock M., and you, and each of you, are notified to appear at said time and place and show cause, if any, why the interlocutory injunction prayed for should not be granted.

Done in open Court this 9th day of March, 1922.

H. G. CONNOR,  
*District Judge.*

*Return on Notice of Hearing.*

Filed March 13, 1922.

Received March 10, 1922, executed March 10, 1922 by delivering a copy of this order to show cause to the following: A. D. Watts, Benjamin R. Lacy, Baxter Durham and Gov. Cameron Morrison.

R. W. WARD,

*U. S. Marshal,*

By JOHN R. WILLIAMS,

*Deputy United States Marshal.*

Fees \$8.00.

Service of within notice accepted and copy received this March 9th, 1922.

JAMES S. MANNING,

*Attorney General of North Carolina.**Affidavit of M. S. Hawkins.*

Filed Mar. 16, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als.

M. S. Hawkins, being first duly sworn, deposes and says that he is Secretary of Norfolk Southern Railroad Company: that Norfolk Southern Railroad Company is a corporation originally created, organized and existing under the laws of the State of Virginia, owned and operates a line of railroad located partly in Virginia and partly in North Carolina and, in addition, during the year 1921, had, and now has, under lease a line of railroad owned by the Atlantic & North Carolina Railroad Company, extending from Goldsboro to Morehead City, and also a lease of the Durham & South Carolina Railroad, extending from Duncan to Durham, and under lease the Carthage & Pinehurst Railroad, extending from Pinehurst to Carthage;

That the line of railroad owned by the Atlantic & North Carolina Railroad Company was held under lease made by the Atlantic & North Carolina Railroad Company to the Howland Improvement Company, bearing date the 1st day of September, 1904, for a term of ninety-one years and four months from the said date, and to

fully ended and completed, commencing the 1st day of September, 1904;

That Norfolk Southern Railroad Company is the successor by assignments and mesne conveyances of said leasehold; that during the year 1921, Norfolk Southern Railroad Company duly paid the rent on said property;

That the Durham & South Carolina Railroad is held under lease bearing date of 27th day of May, 1920, and is for a term of ninety-nine years; that the rent on said property was duly paid for the year 1921;

That the Carthage & Pinchurst Railroad was held under lease made during the period of Federal Control of Railroads and terminated by its terms at the end of Federal Control; that Norfolk Southern Railroad Company continued to operate the same during the year 1921; until it could and did obtain authority from the Interstate Commerce Commission, under the terms of the Transportation Act of 1920, for the cessation of operation of said line of railroad, which authority was duly obtained, and it ceased to operate same in January, 1922.

M. S. HAWKINS.

Sworn and subscribed to before me this 13th day of March 1922.

[SEAL.]

J. R. PRITCHARD,

*Notary Public.*

My commission expired January 10, 1925.

*Affidavit of J. H. Bridgers.*

Filed Mar. 16, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, and Others, Defendants.

J. H. Bridgers, being duly sworn, says: That he is President of Henderson Water Company, a corporation incorporated under the laws of the State of North Carolina and engaged in the business of supplying water to the public in the town of Henderson, N. C.; that the said corporation is engaged in public service. That the said corporation is not required to and does not keep its records according to



the standard classification of accounting of the Interstate Commerce Commission. That after making the deductions allowed it under the Income Tax Act of North Carolina of 1921, the said company has no taxable income. That there is attached to this affidavit and made part hereof a duplicate of the income tax return filed by the Henderson Water Company with the Commissioner of Revenue of North Carolina, as required by the Income Tax Act of North Carolina of 1921, upon which said return it appears that the said company after making the deductions allowed corporations under the provisions of the said Income Tax Act, the Henderson Water Company has no taxable income. That there is also attached hereto and made part of this affidavit a form for income tax return by corporations designated in Section 202 of the Income Tax Act, which has been filled out from the books of the Henderson Water Company and which correctly shows the amount of taxable income upon which the said company would be required to pay the income tax if it came within the corporations designated by said Section 202 and was required to keep its accounts according to the standard classification of accounting of the Interstate Commerce Commission, and from which it appears that said corporation would be required to pay an income tax of \$167.23, if its income taxable under the law were required to be determined on the basis of said return.

J. H. BRIDGERS, L.

Subscribed and sworn to before me this 14 day of March, 1922.

[SEAL.]

J. A. SCOTT,  
Notary Public.

My Commission expires 2 day of May, 1922.

33

## EXHIBIT "A."

Form 8.

State Department of Revenue.

*Public-service Corporation Income Tax Return Other Than Railroad*

For Calendar Year Ending December 31, 1921.

Name and kind of business, Henderson Water Co.  
Business address, Henderson.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the

Revenue Act for 1921 and the Regulations issued under authority thereof.

\_\_\_\_\_,  
President.

\_\_\_\_\_,  
Treasurer.

Sworn to and subscribed before me, this — day of —, 1922.

\_\_\_\_\_,  
(Official capacity.)

Operating Revenues, in this State, including mileage proportion of interstate business as per standard Classification of Accounts of Interstate Commerce Commission .....	\$32,101.83
Operating Expenses, as per standard Classification of Accounts of Interstate Commerce Commission .....	26,079.00
Net operating revenue .....	\$6,022.00
All other income .....	.....
Total income .....	\$6,022.00
Less taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes .....	771.00
Net taxable income .....	52.41
Tax @ 3% .....	\$167.23

34 Railroads and Public-service Corporations; Basis of Ascertaining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this

State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be the net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said

35 net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

## Form 3.

State Department of Revenue.

*Corporation Income Tax Return.*

For Calendar Year Ended December 31, 1921.

(Make Affidavit on This Page for Either Blank.)

Kind of business, Henderson Water Co.—Public Water Supply.  
 Business address, Henderson, N. C.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

(S.)

J. H. BRIDGERS,

*President.*

(S.)

J. H. BRIDGERS,

*Treasurer.*

Sworn to and subscribed before me, this 10 day of Mar., 1922.

\_\_\_\_\_,  
 (Official capacity.)

*Corporation Income Tax Return.—Continued.*

What was the net income for the calendar year 1921 returned to the U. S. Government before taking off any exemption allowed by the Federal law or State income tax .....	\$	None.
Bad debts charged off in Federal return and not deductible in this return .....	\$	None.
Total .....	\$	.....
Deduction.		
Dividends not taxable by State, included in Federal return .....		.....
Net income under State law, all of which is taxable .....	\$	.....
Tax at 3 per cent .....	\$	None.

If Above Form Is Used, It Is Not Necessary to Fill Out This Form.

## Gross Income.

1. Gross sales less returns and allowances .....	\$	.....
Plus inventory close of year .....		.....
2. Less cost of raw materials .....	\$	.....
.....		.....
.....		.....
.....		.....
.....		.....
Wages and labor .....		.....
Total raw materials, wages and labor .....	\$	.....

Plus inventory beginning year.....	\$.....	
Gross income from operation.....		\$32,101.83
3. Gross income from operations other than trading or manufacturing .....	\$.....	
4. Taxable interest received from all sources.....	.....	
5. Rentals .....	.....	
6. Royalties .....	.....	
7. Income received from partnership.....	.....	
8. Total dividends received from foreign corporations, no part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each .....	.....	
9. Total dividends received from foreign corporations, part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each .....	.....	
10. Gross income from all other sources subject to tax.....	.....	
11. Total income, 3 to 10.....	.....	
12. Total gross income, 1 to 11.....	\$.....	

*Corporation Income Tax Return.—Continued.*

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## Deductions.

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business .....	\$ .....
2. Reasonable compensation of officers .....	.....
3. Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade or property to which the taxpayer has not taken, or is not taking title, or in which he has no equity .....	.....
4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purchase of nontaxable securities. Dividends on preferred stock shall not be deducted as interest .....	.....
5. Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed .....	.....
6. Dividends from stock in any corporation the income from which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted. Attach statement of such dividends .....	.....
7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit .....	.....
8. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income as a return made for that year .....	.....



9. A reasonable allowance for depreciation and obsolescence (if any).....			
(b) Depletion (if any).....			
10. Reserve for bad debts, in case of taxpayers who keep regular books of account.....			
11. Total deductions.....			\$.....
12. Difference between gross income (line 12, page 1) and deductions, plus or minus, gain or loss from sale, or other disposition of property, including liquidating dividends.....			\$.....
Kind of property.	Cost, or value, Jan. 1, 1921, if owned prior to that date.	Selling price.	Gain or loss.
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
			Gain or loss,
			.....
13. Net taxable income.....			\$.....
Less contributions or gifts made within the taxable year to corporations or associations, as enumerated in Section 306, Article 3, not exceeding 15 per cent of the net income shown on line 13.....			
14. Net income subject to tax.....			\$.....
15. Three per cent tax on net income shown on line 14.....			\$.....

*Corporation Income Tax Return.—Continued.*

Schedule of Depreciation and Depletion No. 9.

Kind of property.	Cost, or value, Jan. 1, 1921.	Rate.	Depreciation. \$
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....
.....	.....	.....	.....

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Jan. 1, 1921, to Dec. 31.

Balance Sheets.

Assets.

	Give dates.	
	1921, beginning of year.	1921, close of year.
Cash on hand and in banks.....	\$2,602.40	\$1,359.75
Accounts receivable .....	4,397.80	3,748.54
Notes receivable .....	.....	.....
Stocks of other corporations in North Carolina.....	.....	.....
Stocks of other corporations not in North Carolina.....	.....	.....
Bonds of North Carolina.....	.....	.....
U. S. Bonds.....	500.00	.....
Bonds of corporations.....	.....	.....
Inventories.....	.....	.....

	\$	\$	\$
Plant . . . . .			199,572.42
Additions, 1921 . . . . .			213,806.19
. . . . .			.
. . . . .			.
. . . . .			.
. . . . .			.
. . . . .			.
Deferred Assets:			
. . . . .			.
. . . . .			.
. . . . .			.
. . . . .			.
Total assets . . . . .	\$	\$	\$
Liabilities.			
Notes payable . . . . .			\$9,000.00
Accounts payable—Receiver's Certificates . . . . .			10,000.00
Accrued items . . . . .			.
Other liabilities—Bonded Debt . . . . .			97,500.00
Reserve for bad accounts . . . . .			97,500.00
Reserve for depreciation . . . . .			35,672.62
Other Reserves:			
Capital stock—Common . . . . .			65,400.00
Preferred . . . . .			65,400.00
Surplus . . . . .			.
Undivided profits . . . . .			.
. . . . .			.
Total liabilities . . . . .	\$	\$	\$

*Corporation Income Tax Return.—Continued.*

39 Reconciliation of Net Income and Analysis of Changes in Surplus.			
Column 1.		Column 2.	
1. Net income from line —, page — . . . .	\$ . . . . .	4. Unallowable Deductions . . . . .	\$ . . . . .
Nontaxable Income:		(a) Income and profits taxes paid to the U. S., its possessions or foreign countries. . . . .	.....
(a) Interest on obligations of the United States and its possessions wholly exempt. . . . .	.....	(b) Life insurance premiums on lives of officers. . . . .	.....
(b) Interest on obligations of State of N. C. . . . .	.....	(c) Income taxes paid to State of North Carolina . . . . .	.....
(c) Dividends on stock of N. C. corporations subject to N. C. income tax . . . . .	.....	(d) Special improvement taxes tending to increase the value of the property assessed . . . . .	.....
(d) Difference between book profit on sale of capital assets and as shown herein. . . . .	.....	(e) Furniture and fixtures, additions, or betterments treated as expense on the books. . . . .	.....
(e) Charges against reserves for bad debts, contingencies, etc. (to be detailed) . . . . .	.....	(f) Renewals and replacements. . . . .	.....
(a) . . . . .	.....	(g) Interest paid to purchase nontaxable securities . . . . .	.....
(b) . . . . .	.....	(h) Additions to reserves: . . . . .	.....
(c) . . . . .	.....		.....

(c)			
3. Surplus and undivided profits as shown by balance sheet at close of preceding taxable year.	.....	Other Unallowable Deductions:	.....
Other Credits to Surplus:	.....	5. Dividends paid during taxable year.	.....
.....	.....	(a) Date paid	.....
.....	.....	Character	.....
.....	.....	Date paid	.....
.....	.....	Character	.....
.....	.....	Date paid	.....
.....	.....	Character	.....
.....	.....	Date paid	.....
.....	.....	Character	.....
.....	.....	Other Debits to Surplus to be Detailed:	.....
.....	.....	(a)	.....
.....	.....	(b)	.....
.....	.....	(c)	.....
Total Column 1.....	\$.....	Total Column 2.....	\$.....
Surplus and undivided profits shown by balance sheet close of year—Column 1 minus Column 2.....	\$.....		

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*Affidavit of H. W. MacKenzie.*

Filed March 16, 1922.

STATE OF VIRGINIA,

*City of Portsmouth, To wit:*

Personally appeared before me, a Notary Public in and for the City of Portsmouth, State of Virginia, H. W. MacKenzie, a resident of the aforesaid City and State, who, after being duly sworn, says that:

1. He is now the General Auditor of Seaboard Air Line Railway Company and that he has held such office since March 1st, 1920; that as such officer he has general charge of the books and accounts of said Railway Company, including the ascertainment and reporting of the revenue and expenses of said Railway Company.

2. The annexed document marked Exhibit "A" has been prepared under his supervision and direction from the books and accounts of said Railway Company, that he has examined said document and same is a true and correct copy of the return filed under protest of the said Railway Company with the Commissioner of Revenue of North Carolina pursuant to Section 202 of the Income Tax Act, 1921; the figures given therein are true and correct to the best of his knowledge and belief and the taxable income for the year ending December 31st, 1921, shown by such return is \$437,769.52 and the tax thereon \$13,133.09.

3. The statement hereto attached marked Exhibit "B" was prepared under his supervision and direction; that he has examined said statement and that same correctly shows that the net income of the said Railway Company in North Carolina for the year 1921 when such net income is computed in accordance with the classification of accounts prescribed by the Interstate Commerce Commission; that North Carolina intrastate operating revenues are computed with approximate accuracy; that non-operating income, interstate operating revenue and deductions from gross income are apportioned to the State on an equal operated mileage basis; that operating expenses are allocated to the State in the same ratio that the system's operating expenses bear to the system's operating revenues.

H. W. MACKENZIE

Subscribed and sworn to before me, this 14th day of March, 1922.

[SEAL.]

J. M. DREWRY,

*Notary Public*

My commission expires April 21st, 1923.

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## "EXHIBIT "A."

## Form 7.

*Public Service Corporation Income Tax Return.*

(Railroads.)

For Calendar Year Ending December 31, 1921.

Name, Seaboard Air Line Railway Company.

Business address, Portsmouth, Va.

We, the undersigned, Assistant Comptroller and Assistant Treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

(S.)

J. S. HAMILTON,

*Assistant Comptroller.*

(S.)

T. W. MATHEWS,

*Assistant Treasurer.*

Sworn to and subscribed before me, this 28th day of February, 1922.

[SEAL.]

J. M. DREWRY,

*Notary Public.*

(Official capacity.)

My commission expires April 21, 1923.

Net operating income (when business is wholly within the State) . . . . .	\$ . . . . .
Net operating revenue, including equal mileage proportion within this State of the interstate business when business is in part within and in part without the State) . . . . .	8,457,328.52
Other income . . . . .	.....

Total income . . . . .	\$8,457,328.52
------------------------	----------------

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°Operating expenses (when business is wholly within the State) . . . . .	\$ . . . . .
°Proportionate average of operating expenses (when business is in part within and in part without the State) . . . . .	7,308,823.29
°Uncollectible revenue . . . . .	6,342.31
Taxes paid in this State, other than income and war profits and excess profits taxes . . . . .	410,043.38
Total deductions . . . . .	\$7,725,208.98
Operating income, less deductions . . . . .	\$732,119.31
Plus or minus any credit or debit balance received or paid on account of car hire. And when any railroad is partly within and partly without the State then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid . . . . .	\$294,350.00
Net taxable income . . . . .	\$437,769.31
Tax @ 3% . . . . .	\$13,133.08
Main tract mileage (system) . . . . .	3,563.20
Main track mileage (State) . . . . .	627.30

42 Railroads and Public-Service Corporations; Basis of Ascertaining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounts of the Interstate Commerce Commission, shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their *net income within this State shall be ascertained by taking their* gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year.

°As per standard Classification of Accounts of Interstate Commerce Commission.



other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extend of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extend of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

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## EXHIBIT "B."

## Seaboard Air Line Railway Company.

*Statement of Income Applicable to State of North Carolina for Year Ended December 31st, 1921, According to the Classification of Accounts Prescribed by the Interstate Commerce Commission.*

## I. Operating Income:

501. Railway Operating Revenues .....	\$8,457,328.52
531. Railway Operating Expenses .....	7,308,823.29
Net Revenues from Railway Operation .....	1,148,505.23
532. Railway Tax Accruals .....	410,043.38
533. Uncollectible Railway Revenues .....	6,342.31
Railway Operating Income ....	732,119.54

## II. Non-operating Income:

504. Rent from Locomotives .....	6,767.21
505. Rent from Passenger Train Cars .....	16,900.00
506. Rent from Floating Equipment .....	18.22
507. Rent from Work Equipment .....	5,047.23
508. Joint Facility Rent Income .....	12,664.17
509. Income from Lease of Road .....	259,525.95
510. Miscellaneous Rent Income .....	22,387.79
511. Misc. Non-Operating Physical Property .....	7,685.69
513. Dividend Income .....	113,350.45
514. Income from Funded Securities .....	97,257.47
515. Income from Unfunded Securities & Accounts .....	13,781.90
519. Miscellaneous Income .....	1,157.22
Non-Operating Income .....	556,543.30
Gross Income .....	1,288,662.84

## III. Deductions from Gross Income:

536. Hire of Freight Cars—Debits Balance .	277,141.77
537. Rent for Locomotives .....	19,860.90
538. Rent for Passenger Train Cars .....	34,108.35
539. Rent for Floating Equipment .....	2,599.96
540. Rent for Work Equipment .....	510.31
541. Joint Facility Rents .....	34,480.56
542. Rent for Leased Roads .....	10,448.12
543. Miscellaneous Rents .....	3,194.80
546. Interest on Funded Debts .....	1,179,252.90
547. Interest on Unfunded Debt .....	43,823.64
548. Annual allotment of Discount on Bonds	24,494.16
551. Miscellaneous Income Charges .....	685.25
Total Deductions .....	1,542,952.06
Net Loss .....	254,290.31

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*Affidavit of E. H. Kemper.*

Filed March 18, 1922.

United States District Court, Eastern District of North Carolina.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

E. H. Kemper, being first duly sworn, deposes and says that he is Comptroller of Southern Railway Company; that Southern Railway Company is a Corporation originally created, organized and existing under the laws of the State of Virginia, owns and operates a line of railroad located partly in Virginia and partly in North Carolina and partly in other states and, in addition, during the year 1921, had, and now has, under lease certain lines of railroad wholly in the State of North Carolina and certain lines of railroad partly in the State of North Carolina as follows:

(a) Owned by North Carolina Railroad, extending from Goldsboro to Charlotte, N. C.: Raleigh, N. C. Entrance to Union Station and Caraleigh Junction, N. C. held under lease bearing date of August 16, 1895, for a term of ninety nine years from January 1, 1880.

(b) Owned by Atlanta & Charlotte Air Line Railway Company, extending from Charlotte, N. C. to Armour, Ga. held under lease dated March 26, 1881, the agreement to remain in force as long as lessee fulfills its obligations thereunder.

(c) Owned by Atlantic & Danville Railway Company, extending from Danville, Va. to West Norfolk, Va.: Shoulders Hill, Va. &

Portsmouth, Va.: Shops, Va. to Portsmouth, Va.; James River Jet., Va. to Claremont Wharf, Va.; Hitchcock Branch Jet., Va. to Hitchcock Mills, Va. and Buffalo Junction, Va. to Buffalo Lithia Springs, Va. held under lease bearing date of August 31, 1899 for a term beginning September 1, 1899 and ending July 1, 1949.

45 (d) Owned by North and South Carolina Railroad Company, extending from N. & S. C. Junction to Mines, N. C. held under lease bearing date August 31, 1899.

(c) Owned by Southern Railway—Carolina Division, extending from Kingville, S. C. to Marion, N. C.

Sumter Junction, S. C. to Sumter, S. C.

Blacksburg, S. C. to Gaffney, S. C.

Branchville, S. C. to Columbia, S. C.

Biltmore, N. C. to Hayne, S. C.

Hendersonville, N. C. to Lake Toxaway, N. C.

Spartanburg, S. C. to Alston, S. C.

Charleston, S. C. to Savannah River near Augusta Ga.

Burton Branch, S. C.

Cayce, S. C. to Hardeeville, S. C.

Perry, S. C. to Sievern, S. C.

Held under lease bearing date June 30, 1920, for a term of 999 years beginning July 1, 1902.

(f) Owned by North Carolina Midland Railroad extending from Mooresville Junction, N. C. to Winston-Salem, N. C. bearing date of February 5, 1916 and extended for a term to run and continue after December 31, 1920 until the expiration of 30 days in writing by either party to the other of the election to terminate such lease.

E. H. KEMPER.

Sworn and subscribed to before me this 15 day of March 1922.

[Notarial Seal.]

J. C. NAUGHTEN,  
*Notary Public.*

*Answer.*

Filed Mar. 30, 1922.

In the District Court of the United States for the Eastern District  
North Carolina.

In Equity.

No. —.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

v.

A. D. WATTS, Commissioner of Revenue of North Carolina, Benjamin R. Lacy, State Treasurer of North Carolina; Baxter Durham, State Auditor of North Carolina, and James S. Manning, Attorney-General of North Carolina, Defendants.

*Answer.*

To the Honorable H. G. Connor, Judge of the District Court of the United States for the Eastern District of North Carolina:

The defendants above named, answering the bill herein, respectfully show the Court that:

1. Article I of the complaint is admitted.

2. Article II of the complaint is admitted.

3. It is admitted that the amount in controversy herein, exclusive of interest and cost, exceeds the sum of \$3,000. But defendants expressly deny that complainant has any equity to enjoin defendants from collecting the income tax attacked by said complainant; that said railroad company will be deprived of any privilege guaranteed and secured to it by the Constitution of the United States and the Fourteenth Amendment thereof; that it will be deprived of its property without due process of law; that it will be denied the equal protection of the law in contravention of the Constitution of the United States and the Fourteenth Amendment thereof; and that the taxes sought to be imposed by virtue and under the authority of the North Carolina statute constitute a direct burden upon interstate commerce, in violation of the commerce clause of the Federal Constitution.

4. Article IV of the bill is admitted.

5. Article V of the bill is admitted.

6. Article VI of the bill is admitted.

7. Article VII of the bill is admitted.

8. Article VIII of the bill is admitted.

9. Article IX of the bill is admitted.

10. Article X of the bill is admitted.

11. Article XI of the bill is admitted.

12. Article XII of the bill is denied. Further answering said article, defendants respectfully show the Court:

(a) The income-tax provision of the Constitution of the State of North Carolina, quoted in Article IV of the bill, authorizes the Legislature to determine what shall be the net income to be taxed thereunder, and expressly prohibits the allowing of any deduction for living expenses. The statute enacted by the General Assembly of 1921 in pursuance of such constitutional authority (Chapters 34 and 35 of the Public Laws of 1921), classifies income-tax payers as follows, providing for each class a different method for ascertaining taxable incomes: first, resident individuals; second, nonresident individuals, Section 200; third, resident corporations; fourth, nonresident corporations, Section 201; fifth, railroads and other public-service corporations having their lines wholly within the State; and sixth, railroads and other public-service corporations having their lines partly within the State and partly without; and the defendants are advised, and so aver, that such classification does not in any way offend against any provision of the State or Federal Constitution.

48 No one of these classes is allowed the same deduction or exemption as those allowed to the other classes, and in each case the distinctions made are made on account of an inherent difference between the classes themselves.

(b) The statute itself (Section 202) provides the method by which the net income of railroads is to be ascertained. It declares that, as to such railroads operating wholly in the State, the net income shall be "the net operating income" as shown by their records, kept in accordance with the standard classification of accounts of the Interstate Commerce Commission. As to railroads, when their business is part within and part without the State, it declares their net income within the State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business, and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the sum so found, they are allowed to deduct "uncollectible revenue" and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, etc., and the balance shall be deemed to be their net income taxable under this act. The method thus provided by the General Assembly for ascertaining the net income of such railroads, the defendants are advised and aver, is both legally and constitution-

ally a proper one to apply to them, and does not offend against the interstate commerce clause of the Federal Constitution.

(c) That deductions and exemptions are allowed individuals which are not allowed ordinary corporations or railroads, and that deductions are allowed ordinary corporations which are not allowed railroads, in specific terms, arises from the necessity to classify income-tax payers, so as to arrive at their net income, and that necessity arises from differences inherent in the various businesses

49 thus classified. Without such classification, defendants are advised and believe, it would be impossible to levy a fair and just income tax. Defendants are advised and believe that, in applying the method provided in the act, many deductions are necessarily allowed, besides those specifically set out in Section 202, "unobtainable revenue," and taxes paid in this State for the income year etc., i. e., wages of employees, salaries of officers, if reasonable amount, for services actually rendered in producing such income, and others too numerous to incorporate in this answer. A list of them is hereto attached, marked "Exhibit A," and is asked to be taken as part of this answer.

It is admitted that complainant has copied correctly Section 306 of the Revenue Act in subsection (c) of Article XII of its bill, but it is expressly denied that there has been any discrimination against railroads and in favor of ordinary business corporations.

13. Article XIII of the bill is not true as stated, and so is denied.

14. Article XIV of the bill is not true as stated, and so is denied. It is admitted that interest paid during the tax year on outstanding bonded indebtedness is not one of the deductions allowed to railroads whereas it is allowed to individuals and business corporations, but many other deductions are allowed to railroads which are not allowed to either individuals or business corporations. See Exhibit A. Defendants are informed and believe, and so aver, that the method of financing railroads is so wholly different from that of other corporations that they are necessarily in a class to themselves with other public-service corporations, and that a refusal, under such circumstances, to permit a deduction for interest on their bonded indebtedness is justified and is not a discrimination against them. The statute (Section 306, sub-section 3) expressly prohibits the deduction of dividends on preferred stock to business corporations.

50 15. Article XV of the bill is not true as stated, and so is denied. It is expressly averred that the Income Tax Act of 1921 does operate equally and uniformly upon all taxpayers in similar circumstances, and that the variations in its operation are caused by the differences in the character of the objects upon which it operates, and it does in effect classify these various objects to meet the differences, and so the complainant is not denied the equal protection of the law and is not deprived of its property without due process of law in contravention of the Fourteenth Amendment to the Constitution of the United States.

16. Article XVI of the bill is not true as stated, and so is denied. The Constitution of North Carolina, no less than the Federal Constitution, permits classification in a proper case, and defendants aver that the classification in the income-tax law is both just and necessary to comply with the Constitution of the State that such taxes should be uniform.

17. Article XVII of the bill is not true as stated, and so is denied.

18. Article XVIII of the bill is not true as stated, and so is denied. The defendants affirm that the Income Tax Act of 1921 does apply to railroads and public-service corporations deriving their income from sources other than the operation of their property.

19. Article XIX of the bill is not true as stated, and so is denied. Section 3, Article V of the State Constitution, expressly authorizes the General Assembly, at its discretion to tax incomes. If it does determine to tax incomes, it may not in any case exceed 6 per cent; it may not in any case decrease the minimum amount of exemption allowed to individuals. It may allow other deductions, not including living expenses, so that net incomes are taxed. With these limitations, then, the Legislature has authority to determine what is net income.

20. Article XX of the bill is not true as stated, and so is denied. The General Assembly has declared what shall constitute net incomes in the case of railroads, and, as appears by Exhibit A, a very large number of deductions are allowed from gross income in determining what is net income. In no sense, then, defendants aver, can a tax on such income be a tax upon a gross income or a burden on interstate commerce.

21. Article XXI of the bill is not true as stated, and so is denied. Section 202, far from prescribing a system of accounting for an interstate railroad, adopts the system partially already prescribed by Interstate Commerce Commission as a means of arriving at the net income of the complainant earned within the State of North Carolina.

22. Article XXII of the bill is not true as stated, and so is denied. It is true that the General Assembly of North Carolina, under authority conferred upon it by the amendments to the State Constitution, adopted at the general election of 1920, and which became effective January 7, 1921, declined to levy any State ad valorem tax, but left such tax wholly to the counties and other subordinate governmental agencies of the State. It is true that it levied a franchise tax of one-tenth of one per cent upon the value of railroad property in the State for the benefit of the State. It is true, also, that it levied an income tax of 3 per cent upon the net incomes of railroads and all other corporations, but defendants deny that any one or all of these methods of taxation for State purposes constitutes such taxes a burden upon interstate commerce, or violates in any sense the Constitution of the United States.

23. Article XXIII of the bill is not true as stated, and so is denied. The amendments to the State Constitution, commonly called the taxation amendments, were adopted at the general election of 1920, and became effective January 7, 1921. The defendants are advised and believe that such amendments authorized the General Assembly of the State to adopt the general scheme of taxation, which it commenced to put into effect at the Extra Session of August 1920, and put in full force in the Revenue Act of 1921; that the general scheme of taxation is wholly within the authority of the State, and can only be attacked when the legislation enacted in pursuance thereof, or the administration of such taxing laws, destroys some constitutional right of the complainant; that the refusal of the State to levy an ad valorem tax upon the property of the defendant, while it permits subordinate governmental agencies to levy this tax under the rules, regulations and restrictions contained in the State Constitution, can in no sense, as defendants aver and believe, impair any constitutional right of the complainant; that the State, as defendants are advised and believe, may constitutionally levy a license or franchise tax upon complainant for the privilege of performing its functions in the State; an income tax upon income earned in the State, and also an ad valorem tax upon its property for the benefit of the State; that its refusal to levy the latter cannot, as defendants aver, affect the constitutionality of the levy of the franchise and income tax. Defendants particularly deny that there has been any exemption of any class of property from the general burdens of taxation, as alleged in Article XXIII of the bill, and defendants aver that the scheme of taxation of the shares in incorporated companies in the hands of the shareholders, as provided in the Revenue and Machinery Acts of 1921, has been in effect in the State for more than twenty years; said shares being taxed at the principal office of the corporation itself.

24. Article XXIV of the bill is not true as stated, and so is denied. Particularly it is denied that the Revenue Act of 1921 is in any particular retroactive or retrospective within the meaning of Section 1 of Article I of the State Constitution.

25. It is true that the Commissioner of Revenue has sent to complainant the form for return of income tax for the calendar year ending December 31, 1921, attached to the bill. It is admitted that he will proceed to collect, in accordance with the machinery of the law, a proper income tax from complainant, but it is expressly denied that any greater income tax will be collected from complainant than that collected from all other public-service corporations under the same circumstances and conditions; and it is averred that the deductions claimed by complainant are not such as the law allows, and that if complainant pays such taxes under protest it has an adequate remedy at law under Section 600 of the C. S. of 1919.

26. Defendants expressly deny that the penalties provided for failure to pay such income tax in Section 600 of the Revenue Act



excessive, unreasonable, oppressive and inequitable. Those penalties are imposed for wilful or fraudulent failure to comply with the provisions of the act, and so would not be a denial of due process of law to the defendant.

Wherefore, having fully answered all the allegations of the bill herein, the defendants pray judgment:

1. That the bill be dismissed.
2. For cost of this action.
3. For such other and further relief as to the Court may seem just.

JAMES S. MANNING,  
*Attorney-General of North Carolina,*  
FRANK NASH,  
*Assistant Attorney-General of North Carolina,*  
*Solicitors for Defendants.*

GEO. H. BROWN,  
WM. P. BYNUM,  
LOCKE CRAIG,  
THOS. D. WARREN,  
S. S. ALDERMAN,  
*Of Counsel.*

A. D. Watts, one of the defendants, being duly sworn, says that he is State Commissioner of Revenue; that he has read the foregoing answer and knows the contents thereof; that the same is true, of his own knowledge, except as to matters therein stated on information and belief, and as to those matters he believes it to be true.

A. D. WATTS.

Sworn and subscribed to before me, this March 28, 1922.

EDWARD SEAWELL,  
*Deputy Clerk Supreme Court.*

#### EXHIBIT A.

Superintendence; roadway maintenance; underground power lines; tunnels and subways; bridges, trestles, and culverts; ties; rails; track material; ballast; track laying and surfacing; right of way fences; crossings and signs; station and office buildings; roadway buildings; water stations; fuel stations; shops and engine-houses; main elevators; storage warehouses; wharves and docks; telegraph and telephone lines; signals and interlockers; power plant buildings; power transmission systems; power distribution systems; power line poles and fixtures; underground conduits; miscellaneous structures; paving; roadway machines; small tools and supplies; removing snow, ice, and sand; assessments for public improvements; injuries to persons; insurance; stationery and printing; other expenses; superintendence; shop machinery; power plant machinery; steam locomotive

tives—repairs; steam locomotives—depreciation; steam locomotive retirements; freight-train cars—repairs; freight-train cars—depreciation; freight cars—retirements; passenger-train cars—repairs; passenger-train cars—depreciation; passenger-train cars—retirements; motor equipment of cars—repairs; motor equipment of cars—depreciation; floating equipment—repairs; floating equipment—depreciation; work equipment—repairs; work equipment—depreciation; work equipment—retirements; miscellaneous equipment—repairs; miscellaneous equipment—depreciation; injuries to persons; insurance; stationery and printing; other expenses, maintaining joint equipment at terminals; maintaining joint equipment at terminals—Cr.; superintendence; outside agencies; advertising; trade associations; industrial and immigration bureaus; insurance; stationery and printing; other expenses.

Superintendence; dispatching trains; station employees; weighing, inspection, and demurrage bureau; station supplies and expenses; yardmasters and yard clerks; yard conductors and brakemen; yard switch and signal tenders; yard engineers; fuel for yard locomotives; water for yard locomotives; lubricants for yard locomotives; other supplies for yard locomotives; engine-house expenses—yard; yard supplies and expenses; train engineers; train motormen; fuel for train locomotives; water for train locomotives; lubricants for train locomotives; other supplies for train locomotives; enginehouse expenses—train; trainmen; train supplies and expenses; operating sleeping cars; signal and interlocker operation; crossing protection; drawbridge operation; telegraph and telephone operation; operating floating equipment; stationery and printing; other expenses; insurance; clearing wrecks; damage to property; damage to livestock on right of way; loss and damage—freight loss and damage—baggage; injuries to persons; operating joint yards and terminals—Dr.; operating joint yards and terminals—Cr.; operating joint tracks and facilities—Dr.; operating joint tracks and facilities—Cr.; dining and buffet service; hotels and restaurants; producing power sold; salaries and expenses of general officers; salaries and expenses of clerks and attendants; general office supplies and expenses; law expenses; insurance; pensions; stationery and printing; valuation expenses; other expenses; general joint facilities—Dr.; general joint facilities—Cr.; transportation for investment—Cr.

Grand total railway operating expenses, \$37,465,817.12.

66 *Extract from the Minutes of the Court, April 15, 1922.*

In the District Court of the United States for the Eastern District  
of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

VS.

A. D. WATTS et al.

Present: The Honorable Henry G. Connor, Judge of the District  
Court for the Eastern District of North Carolina.

*Order.*

"It is ordered that this cause be set down for final hearing on its  
merits on Monday, June 13, 1922, Counsel for Plaintiff and De-  
fendants being in open Court and assenting thereto; application for  
Interlocutory Injunction being waived by Counsel for Plaintiff."

57 *Affidavit of H. W. Mackenzie.*

Filed May 19, 1922.

In the District Court of the United States for the Eastern District of  
North Carolina.

Equity, #447.

SEABOARD AIR LINE RAILWAY COMPANY

VS.

A. D. WATTS, Commissioner of Revenue, et al.

STATE OF VIRGINIA,  
City of Portsmouth:

Personally appeared before me, a Notary Public in and for the  
City of Portsmouth, State of Virginia, H. W. Mackenzie, a resident  
of the aforesaid City and State, who after being duly sworn says:

1. That he is the General Auditor of Seaboard Air Line Railway  
Company and that he has held such office since March 1st, 1920;  
that as such officer he has general charge of the books and accounts  
of said Railway Company, including the ascertainment and report-  
ing of the revenues and expenses of said Railway Company; that he  
an expert accountant and is thoroughly familiar with accounting.

2. That he attaches hereto as Exhibit A the Classification of Income, Profit and Loss, and General Balance Sheet Accounts for Steam Roads Prescribed by the Interstate Commerce Commission in accordance with Section 20 of the Act to Regulate Commerce, which classification is now in effect and has been in effect since July 1st, 1914

58 3. That he also attaches as Exhibit B Classification of Operating Revenues and Operating Expenses of Steam Roads Prescribed by the Interstate Commerce Commission in accordance with Section 20 of and Act to Regulate Commerce, which classification was in effect and has been in effect since July 1st, 1914

4. That he is thoroughly familiar with the aforementioned classification of accounts of the Interstate Commerce Commission and has been so familiar for many years and that there is no account in the said classification of accounts of the Interstate Commerce Commission designated as Net Operating Income: there is, however, an account designated as Railway Operating Income.

5. That *is* Net Operating Income as employed in Section 209 of the North Carolina Income Tax Act of 1921 is to be construed as the income defined as Railway Operating Income in Section 1 of the Federal Control Act, Section 15-A of the Interstate Commerce Act and Section 209 of the Transportation Act 1920, then the basis of ascertaining such Net Operating Income of a railroad whose business is entirely within the State of North Carolina differs under the said North Carolina Income Tax Act from the method prescribed in the said Act for ascertaining such income for railroad companies whose business is partly within and partly without the State of North Carolina for the reason that those railroads whose business is partly within and partly without the State are not allowed deductions from the gross operating income of the following items, which items, however, are allowed railroads whose business is wholly within the State of North Carolina:

Locomotion hire,  
Working equipment hire,  
Floating equipment hire and  
Joint Facility rents.

59 All of the foregoing accounts are fully set forth and described in the classification of accounts attached hereto. Therefore, railroads and other public service corporations described in Section 2-2 of the said North Carolina Income Tax Act, whose business is wholly within the State of North Carolina, are necessarily entitled under the said Act to the aforementioned deductions and consequently, the Income Tax assessed against them is upon a less proportion of their gross income than is the case with similar companies whose business is partly within and partly without the State of North Carolina, and to the extent that these deductions are allowed a corporation whose business is entirely within the State and denied a similar corporation whose business is partly within and partly without the State, there is an actual discrimination against

corporation whose business is partly within and partly without the State.

6. That under all rules of accounting net income of a corporation is, as a matter of fact, that amount received by such corporation after the deduction from its gross income of all of the expenses of operating its property and that such expenses necessarily include such items as rentals paid for property used in earning said income and interest paid on indebtedness on said property utilized in earning such income.

H. W. MACKENZIE.

Subscribed and sworn to before me this 17th day of May 1922.

J. M. DREWRY,  
*Notary Public.*

My commission expires April 21st, 1923.

I hereby certify that this is a case in which by the laws of Virginia no tax is required upon the affiant.

[Notarial Seal.]

J. M. DREWRY,  
*Notary Public.*

60

*Affidavit of W. L. Stanley.*

Filed May 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

Equity. No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

STATE OF GEORGIA,  
*County of Fulton:*

This day personally appeared before me, C. L. Chappell, a Notary Public in and for the State and County aforesaid, W. L. Stanley, who after being duly sworn, says:

1. That he is General Attorney of the Seaboard Air Line Railway Company, the Complainant in this suit; that he is in general charge of the taxation matters of the said Railway Company and that his duties include the making of returns to enable the authorities of the several states traversed by the said Railway Company to assess the value of the property of the said Railway Company for taxing purposes, of which work he has been in charge for approximately sixteen years.

4-744

2. That under an Act of the General Assembly of North Carolina, ratified the eleventh day of March 1919, and commonly known as "The Revaluation Act," all property including that of railroads was required to be assessed as of the first day of May, 1919, at its true value in money; that in conformity with and in pursuance of this act, the State Tax Commission fixed the value of the property of the Seaboard Air Line Railway Company in the State of North Carolina as of May 1st, 1919, at Thirty-four Million, Seven Hundred Sixty-eight Thousand Four Hundred and Forty Dollars (\$34,768,440.00); That said assessment continued in effect for the year 1920, and that the Commissioner of Revenue of North Carolina has fixed the value of said property as of May 1st, 1921, at the foregoing figure, to-wit: Thirty-four Million Seven Hundred Sixty-eight Thousand Four Hundred and Forty Dollars (\$34,768,440.00).

3. That under Section 82 (61½) of a North Carolina Act entitled "An Act to Raise Revenue," approved March 8th, 1921, the Commissioner of Revenue of North Carolina assessed against the Seaboard Air Line Railway Company for the year 1921 a tax of Thirty-four Thousand Seven Hundred Sixty-eight Dollars and Forty-four cents (34,768.44), said amount being one-tenth of one per cent of the valuation fixed by the said Commissioner as set forth in the preceding paragraph hereof.

4. That the various counties, cities and towns, and other local subdivisions of the State of North Carolina traversed by the line of the said Railway Company have assessed against it for the year 1921 taxes upon the property of the said Railway Company aggregating Four Hundred Twenty-nine Thousand Three Hundred Forty-two Dollars and Eighty-nine Cents (\$429,342.89).

W. L. STANLEY.

Subscribed and sworn to before me in Atlanta, Georgia, this 18th day of May, 1922.

[Notarial Seal.]

C. L. CHAPPELL,  
*Notary Public, State at Large, Georgia.*

My commission expires Nov. 28, 1923.

62

*Affidavit of Nathan O'Berry.*

Filed May 23, 1922.

In the District Court of the United States for the Eastern District of  
North Carolina.

In Equity.

No. 417.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,  
Defendants.

Nathan O'Berry, being first duly sworn, deposes and says:

1. That he is a citizen and resident of the State of North Carolina and County of Wayne, that he is President of Enterprise-Whiteville Lumber Company.

2. That said company is an industrial corporation engaged in operating lumber mills located respectively at Whiteville and Mt. Olive, North Carolina.

3. That said company, as a part of its business constructed a line of railroad extending from Whiteville, N. C., to Butlers, N. C., a distance of about 27 miles, and also constructed a line of railroad extending from Mt. Olive, N. C., to New Camp, N. C., a distance of about 18 miles.

4. That said railroads were established and maintained solely by the owner of the lands upon which the said roads were constructed and the principal business of said railroad is the transportation of logs, lumber and other articles of the owners of said railroad.

5. Acting under the provisions of section 3413 of the Consolidated Statutes of North Carolina, the said corporation applied to the Corporation Commission of North Carolina for authority to said corporation to transport between the termini of said two lines of railroad, commodities other than that owned by the said lumber company, and for authority to charge therefor reasonable rates to be approved by said corporation.

63 6. The Corporation Commission, under the powers vested in it under said section 3414 of the Consolidated Statutes of North Carolina, duly authorized the said corporation to act as a common carrier between the termini of its said two lines of railroad and established a scale of rates which said corporation might charge for the transportation of the kind and character of commodities which it was authorized to transport for others for such services.

7. That the said corporation does not have any tariff filed with Interstate Commerce Commission, and is not authorized to and does not engage in the transportation of freight or passengers in interstate commerce, or between any points other than those on its own line. That the said corporation, during the year 1921, paid interest on account of money borrowed, that the said corporation in making its income tax returns to the Commissioner of Revenue of the State of North Carolina, deducted from its gross income the interest so paid in order to arrive at its net income, this deduction being made in addition to the other deductions allowed under section 306, schedule D of the Revenue Act of North Carolina.

8. This affiant is informed and believes that it was entirely proper under the laws of North Carolina for said corporation to deduct the interest paid during the year 1921 from its gross income, together with the other deductions allowed in section 306 of schedule D Revenue Act of North Carolina from its gross income in order to ascertain the net income subject to tax.

NATHAN O'BERRY.

Sworn and subscribed to before me this 17th day of May, 1922.

[SEAL.]

C. W. BRINKLEY,  
Notary Public.

My commission expires January 24th, 1924.

64

*Affidavit of A. R. Turnbull.*

Filed May 23, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,  
Defendants.

A. R. Turnbull, being first duly sworn, deposes and says:

1. That he is President of the Rowland Lumber Company.

2. Rowland Lumber Company is a corporation duly organized and existing under the laws of the State of North Carolina, the principal business of the said company is the manufacture of lumber.

3. That it operates a large mill in North Carolina, located at New Bern, and has under lease a line of railroad extending from Clarks Junction, a point on the Atlantic & North Carolina Railroad, west-



wardly to and beyond New River and thence to Chinquapin, and a few miles beyond, where it connects with a line of railroad owned by Rowland Lumber Company, which extends to Kenansville, where it connects with a line of railroad owned by Atlantic & Carolina Railroad Company.

4. The principal business of the said railroad running from Kenansville to Clarks Junction, through Chinquapin is the transportation of logs and lumber for the owner of such railroad.

5. The Corporation Commission of North Carolina, acting under the power vested in it by section 3413 Consolidated Statutes of North Carolina, has granted to Rowland Lumber Company authority to transport commodities of certain kinds and character other than owned by the said Rowland Lumber Company over that part of the said line of railroad between Kenansville and Chinquapin and to charge therefor a scale of rates fixed and established by the Corporation Commission of North Carolina.

65 6. Rowland Lumber Company does transport for others than itself commodities of the kind and character authorized by said authority to be transported and charges therefor the scale of rates authorized by the Corporation Commission.

7. That the Rowland Lumber Company is not engaged in interstate commerce and has never filed any tariffs with the Interstate Commerce Commission, and has not been authorized to engage in interstate commerce, and is prohibited under the law from so doing until it has filed tariffs with the Interstate Commerce Commission as required by the Interstate Commerce Act.

8. That during the calendar year 1921, which is the income tax year for 1921 in the State of North Carolina, Rowland Lumber Company paid rent for the line of railroad operated by it as aforesaid and also paid other rents for properties used in its said business and to which it had no equity except its leasehold, and also paid sums as interest for money borrowed and used in its business.

9. Affiant is informed and believes that Rowland Lumber Company is, under the income tax law of North Carolina, schedule D, of Chapter 34, entitled to deduct the amounts so paid as interest and rent, together with other deductions allowed by said schedule from its gross income, in order to arrive at its net income subject to tax under the said tax laws of North Carolina.

10. That the said railroad is of standard gauge and can and does receive cars from other lines of railroad, which it transports to destination on its own line.

A. R. TURNBULL.

Sworn and subscribed to before me this 20th day of May, 1922.

[SEAL.]

J. B. DEY, JR.,

Notary Public.

Com. expires Sept. 18, 1923.

*Affidavit of C. D. Bradham.*

Filed May 25, 1922.

In the District Court of the United States for the Eastern District  
of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

C. D. Bradham, being first duly sworn, deposes and says, that he is President of the Atlantic & North Carolina Railroad Company; that prior to the year 1921, the Atlantic & North Carolina Railroad Company leased to the Howland Improvement Company its line of railroad, extending from Morehead City to Goldsboro, North Carolina.

That the Norfolk Southern Railroad Company is the successor in title to the said leasehold interest granted by said lease and during the year 1921 was in possession of said line of railroad under said lease and used the same exclusively and conducted and carried on the business of a common carrier over said line of railroad.

That during the said year 1921, Norfolk Southern Railroad Company paid the Atlantic & North Carolina Railroad Company the amount of rent required by said lease to be paid for the continued use of said property in the trade or business of Norfolk Southern Railroad Company; that the payment of the said rent was a condition precedent to the continued use of the said property by the Norfolk Southern Railroad Company in its business.

That the Norfolk Southern Railroad Company has not taken title to the said property, was not taking title thereto, and has no equity in the property owned by the Atlantic & North Carolina Railroad Company.

67 That under the terms of the said lease, Norfolk Southern Railroad Company, as Lessee, is required to pay any Income Tax levied upon the income of the Atlantic & North Carolina Railroad Company derived from or under said lease.

That the amount of money received from Norfolk Southern Railroad Company as rent for the use of said property is substantially the entire income of the Atlantic & North Carolina Railroad Company.

C. D. BRADHAM.

Subscribed and sworn to before me this 17th day of May, 1922.

[SEAL.]

H. J. CARPENTER,

Notary Public.

My commission expires on the 7th day of Oct. 1922.

68

*Affidavit of O. S. Thompson.*

Filed June 5, 1922.

In the District Court of the United States for the Eastern District  
of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,  
Defendants.

Railroad Income Tax Suits.

Affidavit of O. S. Thompson.

O. S. Thompson being duly sworn, deposes and says:

Since 1906 affiant has been connected with the Corporation Commission of North Carolina, and with the State Department of Revenue since its creation in 1921. The Corporation Commission, in addition to its duties as such, was by statute created the State Tax Commission with the duties of administering the tax laws of the State. Affiant's position with the said State Tax Commission was that of Tax Clerk, and as such his duties were the general supervision of the details of the administration of the tax laws of the State. While Tax Clerk of the State Tax Commission affiant had extensive experience with the Standard Classification of Accounts of the Interstate Commerce Commission in connection with preparing the reports of the Corporation Commission based in part on the said Standard Classification.

Affiant is now Deputy Commissioner of Revenue of North Carolina and acting Chief Clerk of the State Department of Revenue and his duties as such are similar to those formerly performed by him as Tax Clerk of said State Tax Commission. Prior to 1906 affiant served as an employee of the Southern Railway Company as clerk handling taxation matters.

69 In his capacity as Deputy Commissioner of Revenue and acting Chief Clerk of the State Department of Revenue, the affiant is familiar with the requirements of that department as to returns for taxation by taxpayers, with the forms of such returns, and is custodian of the records of the State Department of Revenue. Affiant is familiar with the administration of the tax laws of the State by the State Department.

The State Department of Revenue has only one blank for returns for income tax which is sent out to and used by all railroad

corporations engaged in the operation of railroads. This is known as Form 7, and is attached to this affidavit, marked Exhibit A. This form is required by the State Department of Revenue to be filled out by all railroads doing business in the State of North Carolina, whether operating partly within or partly without the State, whether operating wholly within the State but as common carriers with interstate railroads, or whether doing wholly intrastate business. This form 7 requires a report by all such railroad corporations of their net income as defined by the Income Tax Act of 1921, under the provisions of section 202 of that Act, and based upon and according to the Standard Classification of Accounts of the Interstate Commerce Commission.

The State Department of Revenue requires all such railroad corporations to make return for income taxation upon this form and ascertain the net income of such railroads for taxation without discrimination according to the provisions of the said section 202.

Affiant has read the affidavits of Nathan O'Berry, President of the Enterprise-Whiteville Lumber Company, and of Mr. A. R. Turnbull, President of the Rowland Lumber Company, filed in their suits by the Norfolk Southern Railroad Company. It is true that these lumber companies and other similar companies are not classed as railroads by the State Department of Revenue, are not treated as railroads for income tax purposes or for any other purposes

whatsoever, and are not required to make returns for income  
70 tax according to the Standard Classification of Accounts and upon Form 7, but are required to and do make return for income

tax on Form 3, which is the form required by the Department for corporations in general other than the railroads and other public service corporations taxed according to section 202. In fact, these lumber companies and other similar companies are not railroads and are not public service corporations. As is stated in the said affidavit by the presidents, their principal business is the lumber business, only such transportation as they carry on is principally the transportation of their own property as incident to the lumber business. Under section 3413, Consolidated Statutes, the Corporation Commission has the power to grant to such companies authority to transport certain commodities other than their own property, subject to the supervision of the Commission, but the affiant is informed and believes that the purpose of such provision is simply to allow such companies to accommodate immediate communities in which they operate; that when such authority is granted to and exercised by such companies they do not engage in the business of transportation as common carriers for others for profit, but only as the purely incidental service of accommodation; that in any such case the transportation of property of others by such a corporation is wholly negligible in amount and purely incidental to the principal business of the corporation, which is the lumber business.

Affiant states, therefore, as a matter of his own knowledge, that the Income Tax Act of 1921, as administered by the State Department of Revenue, applies exactly in the same way and without discrimination whatsoever to all railroad corporations doing business

in the State engaged in railroad operation, whether foreign or domestic, whether operating partly within and partly without the State, or wholly within the State. All are required to make return for income tax according to the Standard Classification of Accounts and under section 202, and exactly the same deductions are allowed to all, without discrimination.

71 Not only is the entire class of railroads subjected to income taxation under the provisions of section 202 with ascertainment of net income upon the basis of the Standard Classification of Accounts, but the same is true as to the broader class of all strictly public service corporations, not including such lumber companies as are above referred to and which the affiant is informed and believes are not public service corporations at all.

The State Department of Revenue has one form for income tax return for all public service corporations other than railroads, Form 8, a copy of which is attached hereto and marked Exhibit B, and which form is substantially identical with Form 7 upon which railroads are required to make return. The Department of Revenue requires, therefore, not only of railroads, but of all other public service corporations, that they file returns for income tax upon the basis of the Standard Classification of Accounts, under the provisions of section 202.

Affiant has read the affidavit of Mr. J. H. Bridgers, President of the Henderson Water Company, in which Mr. Bridgers states that the Henderson Water Company is not required to and does not keep its records according to the Standard Classification of Accounting, and that it did not make return for income taxation according to the said classification under the provisions of section 202. Affiant states that the returns for income taxation in the office of the Department of Revenue for the year ending December 31st, 1921, have not yet been audited and checked for correctness. If what Mr. Bridgers says with reference to the return made by the Company is true, his company will be required to amend its return and to file a return on Form 8 according to the said Standard Classification and under the provisions of section 202. As the Department of Revenue interprets the Income Tax Act, the Henderson Water Company, as well as all other public service corporations, are required to make return for income tax in accordance with the accounting system of the Standard Classification. The auditing of income tax returns for 72 the said year is in progress at this time, but has not been completed, and, with reference to railroads and other public service corporations, has been held over pending decision in these suits as to the validity of the income tax as to such corporations, in view of the plaintiffs' attack upon the income tax law as applied to them.

O. S. THOMPSON,

*Affiant.*

Subscribed and sworn before me this 5 day of June, 1922.

[SEAL.]

W. H. PITTMAN,

*Notary Public.*

My commission expires July 29, 1922.

*Affidavit of A. J. Maxwell.*

Filed June 5, 1922.

In the District Court of the United States for the Eastern District  
North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et al  
Defendants.

Railroad Income Tax Suits.

Affidavit of A. J. Maxwell.

A. J. Maxwell, being first duly sworn, deposes and says:

Affiant is a member of the State Corporation Commission of North Carolina and has been such since 1910, during which time the said commission was, until 1921, also the State Tax Commission with the duties and functions with reference to administering the tax laws of the State imposed upon the newly created State Department of Revenue by the statute of 1921. In such position the affiant has been directly connected in an official capacity with the administration of the tax laws of the State until the creation of the State Department of Revenue to replace the State Tax Commission as such. In such capacity the affiant was in constant consultation with the finance committees of the General Assembly at the time of the drafting of the Income Tax Act of 1921. In such capacity the affiant has had extensive experience familiarizing him with the Standard Classification of Accounts of the Interstate Commerce Commission, has made a special and comparative study of the tax systems of other states and of the subject of taxation.

When the enactment of the Income Tax Act of 1921 was under consideration in the finance committees of the General Assembly, the railroads were heard on the matter and they made the same objection to the provisions of Section 202 that they are now making in the suits. They argued that the application of those provisions

74 to them would not lead to an ascertainment of their net income because certain items, notably interest on bonded indebtedness and rentals paid for leased properties, were not included in the operating expenses in the said Standard Classification, whereas to individuals and to corporations other than public service corporations deductions were allowed under general terms of the act, which the railroads alleged to be analogous to such interest and rentals.

The legislative committees considered these objections fully and carefully. In enacting the Act in the terms finally adopted, the General Assembly considered certain well-known facts with reference to the method in which railroad corporations are financed. It is a general rule that railroads are financed almost entirely by bond issues, their stock being issued largely incidentally and sometimes even distributed as bonus with the bonds. The rule is that the capital expenses are procured by bond issues. This being the case, interest paid on the bonds is properly considered not as a current operating or business expense, but as a capital expense. The legislature considered that "net income" as generally understood and as judicially defined means the business revenues less all those expenses incurred in the earning of such revenues, but not deducting any expense on account of or to provide for capital or permanent investment in the business. It was manifest, therefore, that if interest on bonds should be allowed as a deduction in arriving at net income of railroads, this would be the allowing of a capital expense, not an operating or business expense, and the result obtained after making such deductions in addition to operating and business expenses would not be the net income of the railroad but less.

With reference to the matters of rentals paid for the lines leased and operated by the railroads, the committees considered the well-known facts that these leases are usually for long terms and with numerous collateral obligations which make them amount practically to purchases of the lessor road's properties by the lessee, and that, this being true, the consideration paid for such long leases of property used fully as if operating expense, but is by clear analogy and in practical effort a capital expense. If these expenses are allowed as deductions to the plaintiffs, the result would be that they would have no income subject to tax until they had earned enough to provide not only for all business and operating expenses, but also for all capital expenses and had paid all interest on their bonds; in other words, it would amount to nothing more than a tax on the savings of railroads, which would render the tax utterly incommensurate with that imposed as income tax on individuals and other ordinary corporations.

Affiant states it as his opinion that the Income Tax Act as applied to railroads and other public service corporations under the provisions of Sec. 202 results in a strictly fair and just tax upon their net income, entirely commensurate in scope and burden with the tax imposed on other corporations and individuals, except that perhaps, in view of the fact that individuals are allowed no deduction whatever for living and family expenses, which expenses are analogous to many items allowed all corporations as deductions, the tax bears relatively more heavily on individuals than on corporations by reason of the constitutional inhibition against allowing such deductions to individuals.

As to the contention of the plaintiffs that it is arbitrary classification and discrimination to base a classification on the question whether the taxpayer is required to keep his accounts in accordance with the Standard Classification, the affiant is advised and believes, and so states, that so long as all railroads are placed within the class



and are treated alike without discrimination, the classification is reasonable and not arbitrary, because the distinction of being roads and not other corporations is a practical and reasonable basis of distinction and classification. Affiant asserts further that all roads are taxed alike under the Income Tax Act of 1921. All are required to make return for taxation on Income Tax blank, form

76 according to the Standard Classification of Accounts; that the class is even broader than that of railroads, including all other public service corporations, these being required to make return on Form 8, according to the same Standard Classification, as sworn to in the affidavit of O. S. Thompson filed by the defendants herein.

When railroads keep the Standard Classification of Accounts under Federal or State requirements, the only practical method of requiring return for income tax to be made is according to a classification of accounts, and for the State to require different accounting, would conflict practically with the power of the Interstate Commerce Commission to prescribe uniform classification of accounts. The State of North Carolina has not undertaken to prescribe any system of accounting for the plaintiffs or other railroads in conflict with that already required to be kept by the Interstate Commerce Commission, but has adopted that system as the best and most practical basis for the calculation of net incomes for taxation.

A. J. MAXWELL, Affiant

Subscribed and sworn to before me this the 5 day of June, 1922.  
[SEAL.] W. A. PITTMAN,

Notary Public

My commission expires July 29, 1922.

77 *Affidavit of R. O. Self.*

Filed June 5, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity,

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiffs,  
vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et al.  
Defendants.

Railroad Income Tax Suits.

Affidavit of R. O. Self.

R. O. Self, being duly sworn, deposes and says:

Affiant is the clerk of the State Corporation Commission of North Carolina, has been such since the 1st of September, 1919, and



is the custodian of the records of the said Commission and is thoroughly familiar with the administering by the Commission of duties and powers given it by statute. He is thoroughly familiar with the classification made by the Corporation Commission of corporations subject to its supervision.

Affiant has read the affidavit of Mr. A. R. Turnbull, President of Rowland Lumber Company, which affidavit is filed by the Northern Southern Railroad Company in these suits, and affiant is familiar with contents thereof. He has also read and is familiar with contents thereof. He has also read and is familiar with the contents of affidavit of Mr. Nathan O'Berry, President of the Enterpriseville Lumber Company, filed by the said plaintiff in these suits. The said Rowland Lumber Company, and the said Enterpriseville Lumber Company do what is known as a limited transportation business, and are authorized by the Commission to carry their logging roads certain limited commodities other than their property. These corporations are not railroad corporations, but lumbering corporations. Their lines of tramway, or railroad, are constructed by them for the purpose of hauling logs and lumber and operating their lumber business. When such roads are established there are frequent demands by the community through which they run for them to transport other commodities for the convenience and accommodation of the inhabitants of those communities. Under Section 3413, Consolidated Statutes, the Corporation Commission has the power to, and in proper cases does, grant authority to such logging or lumber companies to carry for hire over their logging, or tramway, roads commodities of others within certain limitations.

These corporations are not classed, considered, or treated by the Corporation Commission as railroads, but they are subjected to the supervision of the Commission, chiefly to prevent discrimination as to the very limited carrier service which they are allowed to perform. They are not classed as common carriers, in the same class as railroads such as the plaintiffs in these suits.

As to the Rowland Lumber Company, it entered into the business referred to in the affidavit of Mr. Turnbull not for profit, but purely for the accommodation of the community, as the following quotations from letters and documents will show:

Letter from Mr. A. R. Turnbull, President, Rowland Lumber Company to W. G. Womble, Rate Clerk, State Corporation Commission, Raleigh, N. C., March 22, 1918:

"It is true that we have been handling fertilizer over the west end of our road for the benefit of the people located in that territory. It is merely an accommodation to them, and is of no benefit to them. \* \* \* If these people do not care for this accommodation it will certainly be a great pleasure for us, under present circumstances to discontinue this hauling of freight for them, as it is done absolutely at cost to us on the present basis."

Letter from Stevens & Beasley, Attorneys for the Rowland Lumber Company, to the North Carolina Corporation Commission dated March 27, 1918. This letter after referring to complaint made by certain citizens of Faison, N. C., against the Rowland Lumber Company for alleged excessive charges for hauling fertilizer says:

"The Rowland Lumber Company is not operating a logging business, over its road, this year, in Sampson County to any extent but is confining its operations to its log road in Duplin. It has even determined to open up its road in Sampson County for the carrying of freight as charged, but was simply coming to the rescue of the farmers in Sampson County, and aiding them, as all good citizens should do, in making food for fighting Germany."

79 For all the winter the roads in that section have been almost impassible with an empty vehicle and had the farmers, many of them 15 miles from the railroad, been permitted by the roads to have hauled at all the cost would have been enormous, from \$3 to \$5 per ton and in this emergency the Rowland Lumber Company has been helping them out at great inconvenience to itself and even loss. \* \* \* Labor conditions are such the cost of operating so high that no one except a man like Mr. Turnbull would have undertaken to deliver the fertilizer to these people and he regrets that they have been so shortsighted as to kick, for it might have been possible for the road to have been developed into a public carrier under his generous impulses and public spirit. In building the Atlantic Carolina Railroad, he has done more for Duplin County than any other one man."

The authority granted to the Rowland Lumber Company, aforesaid, was granted pursuant to petition filed by the Rowland Lumber Company with the Corporation Commission, copy of which is attached hereto and marked Exhibit "A," and which petition shows that it was made purely to accommodate citizens, who requested such service of the Rowland Lumber Company.

On the 27th of February, 1922, Mr. A. R. Turnbull, President of the Rowland Lumber Company, addressed another letter to W. G. Womble, Rate Clerk, Corporation Commission, in which he said:

"As you will understand we are not operating on piece of land west of Bowden, but are simply handling fertilizer, etc., for the commodation of people in that territory. We would be much ahead by discontinuing this service, and will do so if you deem it necessary, but in the meantime, we will do the best we can to give them all the service possible. We have left one locomotive at Bowden to attend to this business and hope to give them better service this year than we have in the past. On the two points, New Grove and Eureka Church, however, there will be some delay, we have notified all shippers whom we know that we do not intend to handle this business except in that way."

There is attached hereto and marked Exhibit "B," a schedule of the rates of the Enterprise-Whiteville Lumber Company over its logging road, effective December 1, 1920, as filed with the Corporation Commission, which schedule shows the limitation as to the commodities carried and allowed to be carried by this road.

These logging roads and others similar to them are not classed as railroads and as full common carriers by the Corporation Commission for the reasons above shown, for the reason that their business carriage of property of others is purely incidental to their business of logging and manufacturing lumber, and is negligible in amount, and for the reason that they maintain no regular schedule of trains, but run simply when there is particular demand for a particular carriage.

R. O. SELF,

*Affiant.*

Subscribed and sworn to before me this 5 day of June, 1922.

[SEAL.]

W. H. PITTMAN,

*Notary Public.*

My commission expires July 29, 1922.

#### EXHIBIT "A."

Rowland Lumber Company.

Norfolk, Va., May 21, 1918.

To the Corporation Commission of North Carolina:

The Rowland Lumber Company respectfully sheweth to the Corporation Commission of North Carolina:

1. That it is a corporation incorporated under the laws of the State of North Carolina, authorized to engage in the Lumber business. In the operation of its timber it has purchased, and caused to be constructed, for logging purposes, a line of railroad running from Greens and Warsaw, on the Atlantic Coast Line Railroad, in Duplin County, North Carolina, in a westerly direction for about twenty miles toward Newton Grove.

2. Your petitioner has been, and is continuously being, requested by the citizens living along the line of this road to transport freight for them and others; your petitioner is willing to accommodate such parties under present conditions, provided it can do so lawfully.

3. Under Revisal of 1905, Sec. 2598, as amended by Chapter 160, Laws of 1911, your Honorable Body is empowered to authorize this company to transport commodities, and to charge therefor reasonable rates, in addition to the transportation of its own commodities:

Wherefore, your petitioner respectfully prays, that your Honorable Body authorize your petitioner to transport over its logging road as freight, commodities in carload lots, but excluding lumber and logs, purchased and used along the line of said road, and to make charges therefor; and that this authority be continued from year to year until your petitioner shall give to this Honorable Body necessary notice of its intention to discontinue said service.

Respectfully submitted,

(S.)                      ROWLAND LUMBER COMPANY,  
By A. R. TURNBULL,  
*President & General Mgr.*

## EXHIBIT "B."

*Rates of Enterprise Lumber Company Railroad.*

Effective December 1, 1920.

Fruit and vegetables, per crate.....	20	20	25	25	25
Fruits and vegetables, per car.....	1500	1650	2000	2250	2500
Empty Crates or Barrels, " ".....	1500	1650	2000	2250	2500
Ditto each.....	10	10	12½	15	15
Fertilizers, 20 Tons Maximum.....	2500	2600	3250	3500	4000
Fertilizers from 10 to 20 tons, per ton minimum 1,500 per car.....	150	175	200	225	275
L. C. L. per ton.....	300	300	350	400	450
Cotton Seed and Hulls.....	2000	2200	2700	3000	3300
L. C. L. per ton.....	200	250	325	375	400
Holly, Lime and Flour in carload.....	2000	2200	2600	2800	3000
Wood—Minimum 10 cords, per c.....	100	100	110	125	150
Cotton, per bale.....	150	150	150	175	175
Furniture, per 100 pounds.....	25	27	30	30	35
Chickens and eggs, per crate.....	30	20	30	30	30
Mdse. not classed, per 100.....	20	20	25	25	30
Brick, minimum 10 per m.....	300	300	300	300	350

All freight is to be loaded and unloaded at expense and risk of shipper. We will not accept any freight either earload or L. C. L. from or to any point except the following:

Oliver's Siding.....	3
Taylor's Siding.....	3 <sup>1</sup> / <sub>2</sub>
Loftin's Siding.....	3 <sup>3</sup> / <sub>4</sub>
King's Crossing.....	5 <sup>1</sup> / <sub>2</sub>
Dobson's Crossing.....	7 <sup>1</sup> / <sub>2</sub>
Hill's or Cherry's Siding.....	9 <sup>1</sup> / <sub>2</sub>
Scott's Store.....	12
Brown's Camp or Snow Hill.....	13
Woodland Siding C. L. only.....	16
Kornegay's Bridge " ".....	17

All cars have to — unloaded on the same day they are placed, or demurrage will be charged. No freight will be shipped collect. Package freight will be carried out only on Fridays and if placed in warehouses on any day previous to Thursday it will be held by the Company at the shipper's risk. Earload shipments will be taken out any day in the week.

ENTERPRISE LUMBER COMPANY  
THOMAS O'BERRY,  
General Mgr.

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*Affidavit of F. C. Harding.*

Filed June 20, 1922.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

F. C. Harding, being duly sworn, deposes and says, that he is the President of the Greenville and Shelberdine Railroad Company; that the same was chartered in 1920; that the road is 12 miles long, extending from Greenville to Shelberdine and is of narrow gauge. That W. L. Hall is the Secretary of said Railroad Company and that David Hoots is General Superintendent, Engineer and Conductor. That this road has no office, either in Greenville or at Shelberdine or along the route of its railroad. That this road makes, as a general thing, one trip a day.

During the movement of fertilizer in the spring, it often makes two trips a day. That it carries freight for hire, from Greenville to any point along the road to Shelberdine and from Shelberdine to any point along the road to Greenville. That it issues no bills of lading. That the freight it carries from Greenville to Shelberdine, or along

the route, is removed from the Atlantic Coast Line Railroad Co. cars and placed in this company's car and is delivered along the route to its several patrons. That while people along the route use this road as a convenience to travel, this company has never charged any passenger rates. That this company has never made any report to the State Corporation Commission or to the Internal Revenue Commissioner and of course has never made any interstate report as it does not do any interstate business as all of its business is intrastate. That this road is not a lumber road. It was originally built for a lumber road but when the Beaufort County Lumber Co., removed from Pitt County, the road was purchased by the present owners who afterwards incorporated under the style above named.

53 Affiant further states that the Greenville and Shelberdine Railroad Company does not keep its accounts according to the standard classification of accounts promulgated by the Interstate Commerce Commission.

F. C. HARDING.

Subscribed and sworn to before me this 20th day of June 1922.

[SEAL.]

M. V. HARDING,  
Notary Public.

My commission expires Nov. 3, 1922.

84 Affidavit of J. C. Nelms, Jr. (May 17, 1922).

Filed June 20, 1922.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

J. C. Nelms, Jr., being first duly sworn, deposes and says: That he is General Auditor of Norfolk Southern Railroad Company; that during the year 1921, Norfolk Southern Railroad Company operated a line of railroad owned by Carthage & Pinehurst Railroad Company, extending from Pinchurst to Carthage, North Carolina, under a lease which had expired, the reason for the continued operation thereof being that it had been prohibited by the laws of the United States to abandon said line of railroad unless permission was granted by the Interstate Commerce Commission;

That during the year 1921, it paid as rent for the use of said property in the business or trade of Norfolk Southern Railroad Company the rent stipulated to be paid in said lease.

That Norfolk Southern Railroad Company had not taken title to and was not taking title to said property, and had no equity therein.  
J. C. NELMS, JR.

Subscribed and sworn to before me this 17th day of May, 1922.  
[SEAL.] GILBERT C. REVEILLE,  
Notary Public.

My commission expires on the 31st day of August 1924.

85 *Affidavit of J. C. Nelms, Jr. (May 18, 1922).*

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.  
Defendants.

Affidavit.

J. C. Nelms, Jr., being first duly sworn, deposes and says:

That he is a citizen and resident of the County of Norfolk, and State of Virginia; that he is General Auditor of Norfolk Southern Railroad Company and has occupied that position since April, 1915; that he is familiar with the rules of accounting for steam and electric railroads as prescribed by the Interstate Commerce Commission.

On the 19th of May, 1914, effective July 1, 1914, the Interstate Commerce Commission issued orders classifying the accounts of steam railroads, and dividing the accounts into two classes:

- (1) Operating Revenues and Operating Expenses; and,
- (2) Income, Profit and Loss, and General Balance Sheet Accounts.

These rules are still in force, subject to such modifications and explanations as have been made by the Commission since that date.

That the order prescribing the classification of Operating Revenues and Operating Expenses of Steam Roads, among other things provided:

"It is ordered, That, the Classification of Operating Revenues and Operating Expenses of Steam Roads and the text pertaining thereto, embodied in printed form to be hereafter known as Issue of 1914, a copy of which is now before this Commission, be, and is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof



in like manner authenticated, in the office of the Division of Carriers' Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

"It is further ordered, That the said Classification of Operating Revenues and Operating Expenses of Steam Roads, with the text pertaining thereto, be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the Act to Regulate Commerce as amended, in the keeping and recording of their operating revenue and operating expense accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all operating revenue and operating expense accounts in conformity therewith; and that a copy of said issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier."

This affiant has a copy of the said order and the classification of accounts and instructions accompanying the same.

Accompanying said order, as sent to the carriers, was an introductory letter, which among other things stated that:

"Accounts are provided in this classification for the revenues and expenses of operations which heretofore have been classed as auxiliary or outside operations. The purpose in merging these accounts has been to secure a statement of revenues and expenses in connection with the operation of all physical property the cost of which is includible in the accounts for investment in road and equipment. The accounts for maintenance of physical property have been arranged to correspond with those for the investment in such property. Depreciation accounts have been provided for the current depreciation of fixed improvements, although until further directed the recognition in operation expenses of current depreciation of fixed improvements is optional with the carrier. It is provided that organization and general administration expenses directly assignable to investments in stocks, bonds, and other securities shall be excluded from the accounts of this classification and included in income account No. 549, 'Maintenance of investment organization.'"

There also accompanied said order and classification certain general instructions, among which were the following:

"1. Operating Accounts.—The accounts of this classification are designed to show the revenues and expenses (including the maintenance of the facilities used) of the carrier's railway operations, including rail-line transportation, water-line transportation, if any, and services incident to transportation. Transportation includes the receipt, conveyance, and delivery of traffic."

"4. Miscellaneous Operations.—The revenue and expenses of miscellaneous operations involving the use of such facilities as hotels and restaurants, power plants, cold-storage plants, coal-storage plants, cotton compress plants, wood-preserving plants, ice-supply plants, etc.,

shall not be included in the accounts of this classification when the facilities used are distinct from those used by the carrier in the service of transportation or in the maintenance of facilities used in transportation service, and the operations are not incident to such service. (See income accounts No. 502, "Revenue from miscellaneous operations," and No. 534, "Expenses of miscellaneous operations," and balance-sheet account No. 705, "Miscellaneous physical property.")"

There also accompanied said order certain special instructions, among which was:

"1. Accounts for Operating Revenues.—The accounts provided for operating revenues are designed to show amounts of money which a carrier becomes entitled to receive from transportation and from operations incident thereto."

The Operating Revenue accounts were by the said classification divided into general accounts and primary accounts. A statement of the general accounts and primary accounts for steam railroads, according to the said classification, showing the number of each account, as set out in said rule and order is hereto attached marked Exhibit A and prayed to be taken as a part of this affidavit.

The said order prescribed that account 142 "Rents of Buildings and other property," should include: "the revenue from the exclusive use of buildings and other property or portions thereof, such as depot and station grounds and buildings, general and other offices, wharves, ferry landings, elevators, stockyards, fuel yards, enginehouses, repair shops, and section and other houses, when the property is operated and maintained in connection with the property used in the carrier's transportation operations and the expenses of maintaining and operating the rented portion cannot be separated from the expenses of that portion used by the carrier."

As to the General Account No. IV, Joint Facility, being primary accounts Nos. 151 and 152, the said order provides that these accounts should include the carrier's proportion of revenue collected by others in connection with the operation of joint tracks, yards, terminals and other facilities, and also that proportion of revenue from the operation of joint tracks, yards terminals and other facilities, which is creditable to other companies.

The account did not include the rent paid for the use of the joint facilities, simply results of operations.

The operating expenses were by said order divided into eight general accounts, and into quite a number of primary accounts. A statement is hereto attached showing the general and primary accounts of steam railroads. Said statement is marked Exhibit B and is prayed to be taken as a part hereof.

The special instructions accompanying said order, among other things, stated that: "The accounts prescribed for operating expenses are designed to show expenses of furnishing transportation

tion service, including the expenses of maintaining the plant used in the service."

The accounts of Norfolk Southern Railroad Company are and have been kept in accordance with the rules and regulations prescribed by the Interstate Commerce Commission as set out in said orders, as explained by the instructions and orders of the Commission, modifying or explaining the aforesaid order of May 19, 1914.

The said accounts and reports made to the Commission in accordance with said rules and regulations do not contain any such term as "Net Operating Income." The reports of Norfolk Southern Railroad Company made to the Interstate Commerce Commission show the total amount of its operating revenues and also shows the total amount of its operating expenses, and also the difference between these two amounts, which in said reports, and under the rules prescribed by the Interstate Commerce Commission, is denominated and known as "Net Revenue from Railway Operations." The Net Revenue from Railway Operations of Norfolk Southern Railroad Company and of corporations operating steam or electric railroads, keeping their accounts in accordance with the standard classification of accounting of the Interstate Commerce Commission, is the difference between the amount of money which Norfolk Southern Railroad Company or such other similar corporations, receives from transportation, as the term "Transportation" is defined in the said classification of accounts and in the Interstate Commerce Act, and the amount paid out for "all the ordinary and necessary expenses paid during the income year for conducting and carrying on transportation, as transportation is defined in the said classification of accounts and in the Interstate Commerce Act, including as a part of said expenses depreciation on its equipment, to-wit: steam locomotives, other locomotives, freight train cars, passenger train cars, motor equipment of cars, floating equipment, work equipment and miscellaneous equipment, if any."

Accounts of operating revenues and operating expenses of steam railroads, such as Norfolk Southern Railroad Company, and other similar corporations, kept in accordance with standard classification of accounting of the Interstate Commerce Commission do not include all gain derived from capital or labor or both combined, provided it is understood that the term "gain" includes profit gained through a sale or conversion of capital assets.

The said operating revenues and operating expenses of steam roads does not include the following items of gain or income which such corporations may receive during any period of time, but said items or sources of revenue or gain are in accordance with said classification carried under what is known as income accounts, to-wit: revenues from miscellaneous operations, hire of freight cars, credit balance, rents from locomotives, rents from passenger train cars, rents from floating equipment, rents from work equipment, joint facility rent income, income from lease of road, miscellaneous rent income, miscellaneous non-operating physical property, separately operated properties,—profit, dividend income, income from funded securities, income from unfunded securities and accounts, in-

come from sinking and other reserve funds, release of premiums on funded debt, contributions from other companies, and miscellaneous income, all of which are gain from labor or capital or both combined, or from a sale or conversion of capital assets.

The accounts of operating revenues and operating expenses of steam railroads, when such accounts are kept in accordance with the standard classification of accounting of Interstate Commerce Commission, do not include all of the expenses of conducting and carrying on the business of the corporation, and do not include many items of expenses which are necessary to be paid in order that the business may be carried on, to-wit: railway tax accruals; uncollectible railway revenues; expenses of miscellaneous operations; taxes on miscellaneous operating property; hire of freight cars—debit balance; rent for locomotives; rent for passenger-train cars; rent for floating equipment; rent for work equipment; joint facility rents; rent for leased roads; miscellaneous rents; miscellaneous tax accruals; separately operated properties—loss; interest on funded debt; interest on unfunded debt; amortization of discount on funded debt; maintenance of investment organization; income transferred to other companies; miscellaneous income charges; income applied to sinking and other reserve funds; dividend appropriations of income; income appropriated for investment in physical property; stock discount extinguished through income; and miscellaneous appropriations of income.

Under the aforesaid orders of the Interstate Commerce Commission dividing the accounts of corporations, operating steam railroads engaged in interstate commerce, into the two general classes as aforesaid, to-wit: Operating Revenues and Operating Expenses on the one part, and Income, Profit and Loss, and General Balance Sheet Accounts on the other, the Interstate Commerce Commission prescribed with great care and particularity the items of revenue which should go into each of the income accounts both credit and debit accounts.

A list of the primary accounts constituting the income accounts under said classification, both credit and debit is hereto attached marked Exhibit C and prayed to be taken as a part hereof.

In addition, the said order of the Commission in prescribing rules of accounting for corporations operating steam railroads engaged in interstate commerce, prescribed a form of income statement. A copy of said form is hereto attached and made a part hereof, marked Exhibit D, and prayed to be taken as a part hereof.

90 The accounts of Norfolk Southern Railroad Company are kept in accordance with the aforesaid classification, its income statement is made to accord with the form of income statement prescribed in said rules of accounting and it reports to the Interstate Commerce Commission its operating revenues, operating expenses and other items of intake and outgo, all as prescribed by the Interstate Commerce Commission.

The term "Operation Ratio" does not appear in said rules of accounting. The term "operating ratio" is generally understood to mean and be that percent which the operating expenses as prescribed by the Interstate Commerce Commission bears to the operating revenues as prescribed by the Interstate Commerce Commission.

The difference between the operating revenue and operating expenses of a corporation operating the steam railroads in keeping its accounts in accordance with the rules of the Interstate Commerce Commission does not show or purport to show the net income of such corporations, but purports to show and shows the difference between the amount of revenue received from the business of conducting and carrying on its transportation and the operations incident thereto and the cost and expense of conducting such transportation and the incidents thereto.

In order to obtain the net income of such corporations it is necessary to consider and take into consideration the income accounts of said corporation as prescribed and shown in the rules of accounting of the Interstate Commerce Commission, and is set out in the form of income statement prescribed by the Commission, and which such railroad companies are required to make to the Commission.

Norfolk Southern Railroad Company owns and operates a line of electric railroad which runs from Norfolk to Virginia Beach and thence to Cape Henry, thence returning to Norfolk. In making reports to the Interstate Commerce Commission under the orders of the Commission the accounts of the electric division and the steam division are combined. Under permission granted by the Interstate Commerce Commission, Norfolk Southern Railroad Company keeps records showing the accounts of the electric division or electric railroad separate from the steam division or steam railroad. No part of the electric railroad is situated in North Carolina. The steam railroad extends and is situated both in North Carolina and Virginia. The ratio of operating expenses to operating revenue of the electric division was for the year 1921, 74.37% and for the steam division 84.51%, and for the entire system including both steam and electric divisions, 83.81%. That is to say that out of every dollar received by Norfolk Southern Railroad Company in payment for services rendered in the conduct of transportation on its electric division, as transportation is defined in classification of accounts of the Interstate Commerce Commission, it paid out in operating expenses, as such operating expenses are defined in said classification of accounts, 74.37 cents. That or its steam division, which is located partly in North Carolina and partly in Virginia, where the business is both local and through, in both states, out of every dollar taken in for services rendered in the conduct of transportation, both intra and interstate, it became necessary to pay, and the company did pay in operating expenses as operating expenses are defined in said classification, the sum of 84.51 cents. That considering its entire system, both electric and steam, out of every dollar taken in payment for services rendered in transportation, both interstate and intrastate, as transportation is defined in the standard classification of accounting of the Interstate Commerce Commission, it becomes necessary for Norfolk Southern Railroad Company to pay for operating expenses in conducting transportation, as transportation is defined in the classification of accounting of the Interstate Commerce Commission 83.81 cents.

That in addition to the operating expenses aforesaid it became necessary for Norfolk Southern Railroad Company, in order to conduct and carry on its business and especially its business on steam division, to pay sums and items as set out in section 23 of the bill of complaint filed in this case.

During the calendar year 1921, which was the income year 1922 Norfolk Southern Railroad Company paid expenses for conducting and carrying on its business which are not included under the head of operating expenses under the rules of accounting of the Interstate Commerce Commission, as follows, to-wit:

Joint Facility Rents, that is rents for tracks, yards, terminals and other facilities owned or controlled by other carriers, companies or individuals, and in the joint use of which Norfolk Southern Railroad Company participated, in the sum of \$37,366.96 of which \$36,009.76 was allocatable in that part of the road located in North Carolina.

For rent of roads, tracks or bridges, including equipment and other railway property covered by the contract of lease of other companies held under lease or other agreement, by the terms of which the exclusive use and control for operating purposes are secured, the sum of \$160,365.96, the entire amount of which was for properties located in North Carolina.

For the use of miscellaneous property, that is property which was not used in the operation of the railroad, but used in the conducting its business and necessary so to be used, the sum of \$1,376.63 of which \$372.83 was allocatable to North Carolina.

For interest on its funded debt the sum of \$884,399.57 of which \$778,351.22 was and is allocatable to the State of North Carolina.

For interest on unfunded debt \$37,025.96, of which \$32,587.00 was allocatable to North Carolina.

92 For amortization of discount on funded debt, being a proportion of the discount and expense on funded debt of the company applicable to that period, in accordance with the standard rules of accounting of the Interstate Commerce Commission \$21,719.53 of which \$21,755.41 was and is allocatable to North Carolina.

Other expenses of conducting and carrying on its business which in the standard classification of accounting of the Interstate Commerce Commission is designated as miscellaneous income charges the sum of \$57,697.34, of which \$50,776.85 is allocatable to the State of North Carolina.

That Norfolk Southern Railroad Company had not taken title, was not taking title, and had no equity in any of the properties leased including the railroads or joint facilities, and which are referred to as having been secured for its use in the conduct of its business by payment of the rents aforesaid.

That under the orders of the Commission, the form of accounting prescribed for operating expenses carried accounts "for the current depreciation of fixed improvements." The said orders and instructions further provided that the recognition of and charging out of operating expenses current depreciation of fixed improvements was optional with the carrier. Norfolk Southern Railroad Company

any has never charged out in its operating expenses any current appreciation for fixed improvements.

(S)

J. C. NELMS, JR.

Sworn and subscribed to before me this 18 day of May, 1922.

(S)

GILBERT C. REVEILLE,

*Notary Public.*

[SEAL.]

My commission expires on the 31st day of August, 1924.

### EXHIBIT A.

#### *Operating Revenue Accounts.*

##### General Accounts.

- I. Transportation—Rail Line.
- II. Transportation—Water Line.
- III. Incidental.
- IV. Joint Facilities.

##### Primary Accounts.

##### I. Transportation—Rail line:

101. Freight.
102. Passenger.
103. Excess baggage.
104. Sleeping car.
105. Parlor and chair car.
106. Mail.
107. Express.
108. Other passenger-train.
109. Milk.
110. Switching.
111. Special service train.
112. Other freight-train.
113. Water transfers—Freight.
114. Water transfers—Passenger.
115. Water transfers—Vehicles and live stock.
116. Water transfers—Other.

##### II. Transportation—Water line—

121. Freight.
122. Passenger.
123. Excess baggage.
124. Other passenger service.
125. Mail.
126. Express.
127. Special service.
128. Other.



## III. Incidental—

- 131. Dining and buffet.
- 132. Hotel and restaurant.
- 133. Station, train, and boat privileges.
- 134. Parcel room.
- 135. Storage—Freight.
- 136. Storage—Baggage.
- 137. Demurrage.
- 138. Telegraph and telephone.
- 139. Grain elevator.
- 140. Stockyard.
- 141. Power.
- 142. Rents of buildings and other property.
- 143. Miscellaneous.

## IV. Joint Facility—

- 151. Joint Facility—Cr.
- 152. Joint Facility—Dr.

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## EXHIBIT B.

*Operating Expense Accounts.*

## General Accounts.

- I. Maintenance of Way and Structures.
- II. Maintenance of Equipment.
- III. Traffic.
- IV. Transportation—Rail line.
- V. Transportation—Water line.
- VI. Miscellaneous operations.
- VII. General.
- VIII. Transportation for investment—Cr.

## Primary Accounts.

## I. Maintenance of Way and Structures—

- 201. Superintendence.
- 202. Roadway maintenance.
- 203. Roadway—Depreciation.
- 204. Underground power tubes.
- 205. Underground power tubes—Depreciation.
- 206. Tunnels and subways.
- 207. Tunnels and subways—Depreciation.
- 208. Bridges, trestles, and culverts.
- 209. Bridges, trestles, and culverts—Depreciation.
- 210. Elevated structures.
- 211. Elevated structures—Depreciation.
- 212. Ties.



213. Ties—Depreciation.
214. Rails.
215. Rails—Depreciation.
216. Other track material.
217. Other track material—Depreciation.
218. Ballast.
219. Ballast—Depreciation.
220. Track laying and surfacing.
221. Right-of-way fences.
222. Right-of-way fences—Depreciation.
223. Snow and sand fences and snowsheds.
224. Snow and sand fences and snowsheds—Depreciation.
225. Crossings and signs.
226. Crossings and signs—Depreciation.
227. Stations and office buildings.
228. Stations and office buildings—Depreciation.
229. Roadway buildings.
230. Roadway buildings—Depreciation.
231. Water stations.
232. Water stations—Depreciation.
233. Fuel stations.
234. Fuel stations—Depreciation.
235. Shops and enginehouses.
236. Shops and enginehouses—Depreciation.
237. Grain elevators.
238. Grain elevators—Depreciation.
239. Storage warehouses.
240. Storage warehouses—Depreciation.
241. Wharves and docks.
242. Wharves and docks—Depreciation.
243. Coal and ore wharves.
244. Coal and ore wharves—Depreciation.
245. Gas producing plants.
246. Gas producing plants—Depreciation.
247. Telegraph and telephone lines.
248. Telegraph and telephone lines—Depreciation.
249. Signals and interlockers.
250. Signals and interlockers—Depreciation.
251. Power plant dams, canals, and pipe lines.
252. Power plant dams, canals, and pipe lines—Depreciation.
253. Power plant buildings.
254. Power plant buildings—Depreciation.
255. Power substation buildings.
256. Power substation buildings—Depreciation.
257. Power transmission systems.
258. Power transmission systems—Depreciation.
259. Power distribution systems.
260. Power distribution systems—Depreciation.
261. Power line poles and fixtures.
262. Power line poles and fixtures—Depreciation.

- 263. Underground conduits.
- 264. Underground conduits—Depreciation.
- 265. Miscellaneous structures.
- 266. Miscellaneous structures—Depreciation.
- 267. Paving.
- 268. Paving—Depreciation.
- 269. Roadway machines.
- 270. Roadway machines—Depreciation.
- 271. Small tools and supplies.
- 272. Removing snow, ice and sand.
- 273. Assessments for public improvements.
- 274. Injuries to persons.
- 275. Insurance.
- 276. Stationery and printing.
- 277. Other expenses.
- 278. Maintaining joint tracks, yards, and other facilities  
Dr.
- 279. Maintaining joint tracks, yards, and other facilities  
Cr.

## II. Maintenance of Equipment—

- 301. Superintendence.
- 302. Shop machinery.
- 303. Shop machinery—Depreciation.
- 304. Power plant machinery.
- 305. Power plant machinery—Depreciation.
- 306. Power substation apparatus.
- 307. Power substation apparatus—Depreciation.
- 308. Steam locomotives—Repairs.
- 309. Steam locomotives—Depreciation.
- 310. Steam locomotives—Retirements.
- 96 311. Other locomotives—Repairs.
- 312. Other locomotives—Depreciation.
- 313. Other locomotives—Retirements.
- 314. Freight-train cars—Repairs.
- 315. Freight-train cars—Depreciation.
- 316. Freight-train cars—Retirements.
- 317. Passenger-train cars—Repairs.
- 318. Passenger-train cars—Depreciation.
- 319. Passenger-train cars—Retirements.
- 320. Motor equipment of cars—Repairs.
- 321. Motor equipment of cars—Depreciation.
- 322. Motor equipment of cars—Retirements.
- 323. Floating equipment—Repairs.
- 324. Floating equipment—Depreciation.
- 325. Floating equipment—Retirements.
- 326. Work equipment—Repairs.
- 327. Work equipment—Depreciation.
- 328. Work equipment—Retirements.
- 329. Miscellaneous equipment—Repairs.

- 330. Miscellaneous equipment—Depreciation.
- 331. Miscellaneous equipment—Retirements.
- 332. Injuries to persons.
- 333. Insurance.
- 334. Stationery and printing.
- 335. Other expenses.
- 336. Maintaining joint equipment at terminals—Dr.
- 337. Maintaining joint equipment at terminals—Cr.

### III. Traffic—

- 351. Superintendence.
- 352. Outside agencies.
- 353. Advertising.
- 354. Traffic associations.
- 355. Fast freight lines.
- 356. Industrial and immigration bureaus.
- 357. Insurance.
- 358. Stationery and printing.
- 359. Other expenses.

### IV. Transportation—Rail line—

- 371. Superintendence.
- 372. Dispatching trains.
- 373. Station employees.
- 374. Weighing, inspection, and demurrage bureaus.
- 375. Coal and ore wharves.
- 376. Station supplies and expenses.
- 377. Yardmasters and yard clerks.
- 378. Yard conductors and brakemen.
- 379. Yard switch and signal tenders.
- 380. Yard enginemen.
- 381. Yard motormen.
- 382. Fuel and yard locomotives.
- 383. Yard switching power produced.
- 384. Yard switching power purchased.
- 385. Water for yard locomotives.
- 386. Lubricants for yard locomotives.
- 387. Other supplies for yard locomotives.
- 388. Enginehouse expenses—Yard.
- 389. Yard supplies and expenses.
- 390. Operating joint yards and terminals—Dr.
- 391. Operating joint yards and terminals—Cr.
- 392. Train enginemen.
- 393. Train motormen.
- 394. Fuel for train locomotives.
- 395. Train power produced.
- 396. Train power produced purchased.
- 397. Water for train locomotives.
- 398. Lubricants for train locomotives.
- 399. Other supplies for train locomotives.

- 400. Enginehouse expenses—Train.
- 401. Trainmen.
- 402. Train supplies and expenses.
- 403. Operating sleeping cars.
- 404. Signal and interlocker operation.
- 405. Crossing protection.
- 406. Drawbridge operation.
- 407. Telegraph and telephone operation.
- 408. Operating floating equipment.
- 409. Express service.
- 410. Stationery and printing.
- 411. Other expenses.
- 412. Operating joint tracks and facilities—Dr.
- 413. Operating joint tracks and facilities—Cr.
- 414. Insurance.
- 415. Clearing wrecks.
- 416. Damage to property.
- 417. Damage to live stock on right of way.
- 418. Loss and damage—Freight.
- 419. Loss and damage—Baggage.
- 420. Injuries to persons.

V. Transportation—Water line—

- 431. Operation of vessels.
- 432. Operation of terminals.
- 433. Incidental.

VI. Miscellaneous operations—

- 441. Dining and buffet service.
- 442. Hotels and restaurants.
- 443. Grain elevators.
- 444. Stockyards.
- 445. Producing power sold.
- 446. Other miscellaneous operations.

VII. General—

- 451. Salaries and expenses of general officers.
- 452. Salaries and expenses of clerks and attendants.
- 453. General office supplies and expenses.
- 98 454. Law expenses.
- 455. Insurance.
- 456. Relief department expenses.
- 457. Pensions.
- 458. Stationery and printing.
- 459. Valuation expenses.
- 460. Other expenses.
- 461. General joint facilities—Dr.
- 462. General joint facilities—Cr.

VIII. Transportation for investment—Cr.

## EXHIBIT C.

*Income Accounts.*

## Primary Accounts.

## I. Credits:

501. Railway operating revenues.
502. Revenues from miscellaneous operations.
503. Hire of freight cars—Credit balance.
504. Rent from locomotives.
505. Rent from passenger-train cars.
506. Rent from floating equipment.
507. Rent from work equipment.
508. Joint facility rent income.
509. Income from lease of road.
510. Miscellaneous rent income.
511. Miscellaneous non-operating physical property.
512. Separately operated properties—Profit.
513. Dividend income.
514. Income from funded securities.
515. Income from unfunded securities and accounts.
516. Income from sinking and other reserve funds.
517. Release of premiums on funded debt.
518. Contributions from other companies.
519. Miscellaneous income.

## II. Debits:

531. Railway operating expenses.
532. Railway tax accruals.
533. Uncollectible railway revenues.
534. Expenses of miscellaneous operations.
535. Taxes on miscellaneous operating property.
536. Hire of freight cars—Debit balance.
537. Rent for locomotives.
538. Rent for passenger-train cars.
539. Rent for floating equipment.
540. Rent for work equipment.
541. Joint facility rents.
542. Rent for leased roads.
543. Miscellaneous rents.
544. Miscellaneous tax accruals.
545. Separately operated properties—Loss.
546. Interest on funded debt.
547. Interest on unfunded debt.
548. Amortization of discount on funded debt.
549. Maintenance of investment organization.
550. Income transferred to other companies.
551. Miscellaneous income charges.

- 552. Income applied to sinking and other reserve funds.
- 553. Dividend appropriations of income.
- 554. Income appropriated for investment in physical property.
- 555. Stock discount extinguished through income.
- 556. Miscellaneous appropriations of income.

## EXHIBIT D.

*Form of Income Statement.*

## I. Operating income—

- 501. \*Railway operating revenues.
- 531. \*Railway operating expenses.
- \*Net revenue from railway operations.
- 532. \*Railway tax accruals.
- 533. \*Uncollectible railway revenues.
- \*Railway operating income.
- 502. Revenues from miscellaneous operations.
- 534. Expenses of miscellaneous operations.
- Net revenue from miscellaneous operations.
- 535. Taxes on miscellaneous operating property.
- Miscellaneous operating income.
- Total operating income.

## II. Non-operating Income—

- 503. Hire of freight cars—Credit balance.
- 504. Rent from locomotives.
- 505. Rent from passenger-train cars.
- 506. Rent from floating equipment.
- 507. Rent from work equipment.
- 508. Joint facility rent income.
- 509. Income from lease of road.
- 510. Miscellaneous rent income.
- 511. Miscellaneous non-operating physical property.
- 512. Separately operated properties—Profit.
- 513. Dividend income.
- 514. Income from funded securities.
- 515. Income from unfunded securities and accounts.
- 516. Income from sinking and other reserve funds.
- 517. Release of premiums on funded debt.
- 518. Contributions from other companies.
- 519. Miscellaneous income.
- Total non-operating income.
- Gross income (or loss).

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\*Includes operations of water lines, if any.

## III. Deductions from gross income:

536. Hire of freight cars—Debit balance.  
537. Rent for locomotives.  
538. Rent for passenger-train cars.  
539. Rent for floating equipment.  
540. Rent for work equipment.  
541. Joint facility rents.  
542. Rent for leased roads.  
543. Miscellaneous rents.  
544. Miscellaneous tax accruals.  
545. Separately operated properties—Loss.  
546. Interest on funded debt.  
101 547. Interest on unfunded debt.  
548. Amortization of discount on funded debt.  
549. Maintenance of investment organization.  
550. Income transferred to other companies.  
551. Miscellaneous income charges.  
Total deductions from gross income.  
Net income (or loss).

## IV. Disposition of Net Income:

552. Income applied to sinking and other reserve funds.  
553. Dividend appropriations of income.  
554. Income appropriated for investment in physical property.  
555. Stock discount extinguished through income.  
556. Miscellaneous appropriations of income.  
Total appropriations.  
Income balance transferred to credit (or debit) of Profit and Loss.

102 *Affidavit of J. C. Nelms, Jr. (June 12, 1922).*

Filed June 20, 1922.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS et al.

J. C. Nelms, Jr., being first duly sworn, deposes and says; that: Accompanying and constituting a part of the order of the Interstate Commerce Commission, made the 19th day of May, 1914, effective July 1st, 1914, and still in force, with such modifications and amendments as may have been made thereto, were certain special instructions of which No. 1 reads as follows:

"Income accounts are those designed to show, as nearly as practicable, for each fiscal period, the total amount of money that a carrier becomes entitled to receive for services rendered, the returns accrued upon investments, the accrued costs paid or payable for the services rendered by it, the losses sustained by it, the amounts accrued for taxes, for use of moneys and for use of properties of others, and the appropriations made from income during the period. The net balance of income (or loss) shall be carried to Profit and Loss."

The order above referred to is the order of the Commission regulating the keeping of records by Interstate Carriers by Railroad, known as "Classification of Income, Profit and Loss, and General Balance Sheet Accounts for Steam Roads."

J. C. NELMS, Jr.

Sworn and subscribed to before me this 12th day of June, 1922

[SEAL.]

GILBERT C. REVEILLE,

Notary Public.

My commission expires the 31st day of August, 1924.

103 *Testimony of R. O. Self at Hearing Before Judge Connor.*

It is agreed that all affidavits filed in the cause by either of the plaintiffs or by the defendants will be treated as in evidence in all cases.

Mr. R. O. Self, Clerk of the North Carolina Corporation Commission produced a list of the corporations operating as limited common carriers in North Carolina under authority granted by the State Corporation Commission under section 3413 of the Consolidated Statutes of North Carolina. Also a memorandum adding two other roads was attached, all filed as Exhibit A.

R. O. SELF, witness for the defendant, examined by Judge Manning, testifies as follows:

That the several roads mentioned in Exhibit A were lumber roads for logging purposes, operating under Section 3413 of the Consolidated Statutes as a limited carrier, with the right to stop at anytime

104 EXHIBIT "A" TO TESTIMONY OF R. O. SELF.

Office of the Corporation Commission.

STATE OF NORTH CAROLINA:

This is to certify, that the Corporation Commission of North Carolina, acting under power vested in it by Sec. 3413 of the Consolidated Statutes of North Carolina, has granted authority to the corporations named below to conduct and carry on the business of limited common carriers between the points designated as to each



of the corporations named, and that said corporations have filed with the Corporation Commission of North Carolina tariffs establishing the rate of charges which they are authorized to make for the transportation of commodities between the points named.

The corporations named and the points between which they are authorized to act as limited common carriers, engaged in Intra-state Commerce in North Carolina over a line of steam railroad, are as follows:

Andrews Manufacturing Company, Between Andrews and Old Road Gap, a distance of 8 miles, of thereabouts.

Carr Lumber Company, Between Pisgah Forest and Vanderbilt Boundary, a distance of about 20 miles.

Empire Manufacturing Company, Between Oliver Station to within three miles of Bentonville, about 13 miles.

Enterprise Lumber Company, Between Mount Olive and New Camp, a distance of 18 miles, or thereabouts.

Fishing Creek Timber & Railroad Company, Between Stamper, N. C., and Coffield's Bridge, about 10 miles.

Carolina Southern Railroad, Between Hollister and Vaughan, a distance of 14½ miles, or thereabouts.

Montgomery Lumber Company, Between Spring Hope and Bunn, N. C., a distance of 10 miles or thereabouts.

105 Ocona Luffy Railroad Company, Between Ocona Luffy, N. C., and Smokemont, N. C., about 10 miles.

Rowland Lumber Company, Between Bowdens, N. C., and Warsaw, N. C., toward Newton Grove, a distance of about 20 miles.

Waccamaw Lumber Company, Between Bolton and Makatoka, a distance of about 18 miles.

Weldon Lumber Company, Between Weldon, N. C., and a point near Ringwood, a distance of about 20 miles.

Whiteville Lumber Company, Between Whiteville, N. C., and Buttler, a distance of about 27 miles.

Mill Creek Valley Railroad Between — and — a distance of about — miles.

Suncrest Lumber Co., Sunburst to Canton.

Hilton Railroad & Lugging Co., Hilton Creek to Island Creek, 6 miles.

Done at the office of the Corporation Commission, at Raleigh, on this the — day of May 1922, by the Corporation Commission, through W. T. Lee, its Chairman, and under the seal of the said Commission.

106 *Testimony of C. J. Joseph at Hearing Before Judge Connor.*

C. J. Joseph, Tax Agent of the A. C. L. Railroad, witness for the Plaintiff, examined by Mr. Thomas W. Davis, testifies as follows:

That he had for a great many years been the tax agent of that road, with the duty of checking and looking after all the taxes of that Company and its affiliated lines in Virginia, North and South

Carolina, Georgia, Florida and Alabama. That he was familiar with this litigation and with the Income Tax Laws of North Carolina that he has to keep up with the stocks and bonds and statistics of the various roads mentioned: that he is familiar with the commercial and financial Chronicle, a financial trade paper, circulated throughout the United States, that collects roads and industrial corporations and their stocks and bonds. The issue of May 27, 1922, of that paper was offered in evidence, and Mr. Davis desired to read into the record the capital stock and bonds of certain industrial corporations reporting to the North Carolina Tax Commission, the Tax Commission showing the capital, but not the bonds issued by them.

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## EXHIBIT TO TESTIMONY OF C. J. JOSEPH.

*Representative Partial List of Industrial Corporations Doing Business in North Carolina and Reporting to the North Carolina Corporation Commission and Commissioner of Revenue Financed by Bonds and Stocks.*

## American Agricultural Chemical Company:

Common stock .....	\$33,322.13
Preferred Stock .....	28,453.20
First Mortgage bonds .....	6,252.00
1st Ref. Mortgage s. f. gold bonds, Series "A" ..	30,000.00

## American Sugar Refining Company:

Common Stock .....	45,000.00
Preferred Stock .....	45,000.00
15 Year Gold Bonds .....	30,000.00

## American Tobacco Company:

Common Stock "A" .....	40,242.40
Common Stock "B" .....	49,344.20
Preferred Stock .....	52,699.70
Gold Bonds .....	371.85
Gold Bonds & Cons, Tobacco Collateral Trust	
Mortgage Bonds .....	1,365.30
Series of Gold Notes .....	10,000.00
8% Dividend Certificates .....	8,058.50

## Dupont, I. E., de Nemours &amp; Company:

Common stock .....	63,378.50
Debenture Stock .....	71,243.35
10 Year Gold Bonds .....	35,000.00

## Galena Signal Oil Company:

Common Stock .....	16,000,000
Preferred Stock .....	2,000,000
New Preferred Stock .....	4,000,000
Convertible Debenture .....	6,000,000
Entire Stock of Subsidiary Companies .....	2,800,000
Galena Signal Oil of Texas Bonds .....	2,800,000

## General Electric Company:

Common Stock .....	176,329,100
Debenture for Sprague Stock .....	2,047,000
Debenture .....	15,136,500
Debenture Bonds .....	15,000,000

## Kelly Springfield Tire Company:

Common Stock .....	9,096,002
Preferred Stock .....	3,137,100
Second Preferred .....	5,625,200
10 Year s. f. Gold Notes .....	10,000,000

## Morris Company:

1st Mortgage .....	\$17,626,000
10 Year s. f. Gold Notes .....	15,000,000
Wm. F. Mosser Co. 10 yr. s. f. notes .....	3,000,000

## Swift &amp; Company:

Common Stock .....	150,000,000
1st Mortgage s. f. Gold Bonds .....	28,923,500
Gold Notes .....	65,000,000

## Texas Company:

Stock .....	164,450,000
3 yr. S. F. Notes .....	22,772,000

*Final Decree.*

Filed Nov. 13, 1922.

In the District Court of the United States for the Eastern District of  
North Carolina, Raleigh Division.

In Equity.

No. 447.

THE SEABOARD AIR LINE RAILWAY CO.

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, and  
JAMES S. MANNING, Attorney General of North Carolina.

*Decree.*

This is a suit in equity, brought by plaintiff, The Seaboard Air Line Railway Co., a corporation chartered and organized under the laws of the State of Virginia, operating a line of railway in and through the State of North Carolina and the Eastern District thereof, against defendant, A. D. Watts, individually, and as Commissioner of Revenue of North Carolina and James S. Manning, Attorney General of said State, seeking an injunction restraining and enjoining said defendants from taking or causing to be taken any action toward enforcing the filing of a return or the collection of a tax or any part thereof, imposed, or sought to be imposed by the State of North Carolina upon the plaintiff, under or by virtue of the provisions of the Public Laws of North Carolina of 1921, Chapter 34, known as the Revenue Act or the Income Tax Act, as amended by the General Assembly of North Carolina at its Special Session of 1921.

Following the service of process on the defendants and filing answer to the bill, the cause was set down for hearing upon the bill.  
110 answer and evidence.

Plaintiff alleges that, by the provisions of Article 5, Section 3 of the Constitution of North Carolina, the General Assembly is authorized to pass laws.

"Taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock Companies, or otherwise, and also real and personal property, according to its true value in money. \* \* \* The General Assembly may also tax trades, professions and incomes. Provided the rate of tax on incomes shall not in any case exceed six per cent, and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes to-wit: For a married man, with a wife living with him, or to a widow or widower having a minor child or children, natural or adopted, not less than \$2,000."

to all other persons not less than \$1,000.00; and there may be allowed other deductions (not including living expenses), so that only net incomes are taxed."

Pursuant to the provisions of the foregoing Art. of the Constitution, the General Assembly, at its Session of 1921, enacted a statute providing for levying, collecting and paying an income tax on individuals and corporations. Chap. 34 Public Laws of North Carolina and known as a part of the Revenue Act of 1921, or, so far as it relates to the Income Tax, as the "Income Tax Act of 1921."

The sections of this Act pertinent to the questions presented for decision by the plaintiff's contention are:

#### Section 101. Purpose.—

"The general purpose of this Act is to impose a tax for use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922 and annually thereafter:

- (a) Of every citizen of the State.
- (b) Of every domestic corporation.
- (c) Of every foreign corporation and of every non resident individual having a business or agency in this State in proportion to the net income of such business or agency.

"Except as otherwise provided in this Act, the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority in so far as they apply."

"The tax imposed upon the net income of corporations in this Schedule is in addition to the tax imposed under Schedule "C" of this Act."

#### Section 201. Corporations.—

Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

In case of a Company other than Companies mentioned in the next succeeding section, deriving profits principally from the ownership sale or rental of real estate or from the manufacture sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property, in this State, on the date of the close of the fiscal year of such Company in the income year is to be the fair

cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of intangible property such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

“Section 202. Railroads and public service corporations.—

“The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, shall be the ‘net operating income’ of such corporations as shown by their records kept in accordance with that Standard Classification of Accounts, when their business is wholly within this State, and when their business is in part within and in part without this State, including in their gross ‘operating revenues’ within this State the equal mileage proportion within the State of their interstate business and deducting from their gross ‘operating revenues’ the proportionate average of operating expenses in ‘operating ratio’, for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts.”

From the net operating income thus ascertained shall be deducted ‘uncollectible revenue,’ and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this Act.”

The foregoing section relating to the basis of ascertaining the net income of railroads was supplemented by Chapter 35 of the Public Laws of 1921, as follows:

“Sec. 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire, and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within the State of any credit or debit balance received or paid, as the case may be, on account of car hire.”

Section 203 of the Income Tax Act of 1921, as amended by Chapter 35, Public Laws of 1921, is as follows:

“Section 203. Such tax shall first be levied, collected and paid for the year 1922, and with respect to the net income received during the calendar year 1921, and annually thereafter.”

Section 3 of Chapter 34, Public Laws of 1921, provides:

114 "No tax on any property in the State shall be levied for any uses of the State Government. The taxes hereinafter levied in this Act are for the expenses of the State Government, the appropriations to its educational, charitable and penal institutions, pensions for Confederate Soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

"Section 306. Deductions.—

"In computing net income there shall be allowed as deductions:

"1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

"(a) As to individuals, wages of employees for services actually rendered in producing such income.

"(b) As to partnerships, wages of employees and a reasonable allowance for co-partners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the co-partner receiving same.

"(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

"2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

"4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

"5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this Act: Provided, that when only part of the income of any corporation shall have been assessed under this Act only a corresponding part of the dividends received therefrom shall be deducted.

"6. Losses sustained during the income year and not compensated by insurance or otherwise, if incurred in any transaction entered into for profit.

"7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this Act.

"8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deduction allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits the cost of development, not otherwise determined) and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowance under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the 116 deductions allowed may be equitably apportioned between the lessor and lessee.

"9. In the case of taxpayers who keep regular books of account upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall, at any time, deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

"10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income computed without the benefit of this subdivision.

"11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deductions authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services or mortgages, stocks, bonds, securities and deposits.

"12. In the case of a non-resident individual, the deductions allowed in this section shall be allowed only if, and to the extent that they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission." 117



Complainant is engaged in operating an interstate railroad and keeps its accounts in accordance with the Standard Classification of Accounts prescribed by the Interstate Commerce Commission and is required to pay an income tax under the appropriate part of Section 202 of the Income Tax Act or suffer the penalties prescribed in said Act.

Complainant respectfully shows the Court that the said Act is valid as to complainant for the following reasons:

(a) Article 5, Section 3 of the Constitution of North Carolina authorizes the levy of a tax upon net incomes, and the statutory method prescribed in Section 202 for complainant and like corporations in order to arrive at net income results in the tax being levied on a sum which is not in truth and in fact net income, but includes a part of complainant's operating revenue in this:

Section 202 provides that railway corporations in the class of complainant shall first arrive at gross operating revenue within the State in its interstate business, and from this gross revenue shall deduct the following items:

(1) Proportionate average of operating expenses, as shown by the Interstate Commerce Commission Standard Classification of Accounts.

(2) Uncollectible revenue.

(3) Taxes paid in North Carolina for the income year, other than income taxes and war profits and excess profits taxes.

(4) An equal mileage proportion of car hire.

Plaintiff alleges that defendants, unless restrained by order of this Court, will, pursuant to the provisions of the Statutes in force in the State of North Carolina, levy upon and assess against it the income taxes for the year 1922 and certify such levy and assessment to the officers charged with the enforcement and collection thereof, amounting to a large sum in excess of \$3,000.00. Plaintiff avers that if it is allowed the deductions to which it is entitled it would not have any taxable income because the sum of such deductions is greater than its gross income, and that unless said taxes are paid within the time required by the Statute, plaintiff will be subjected to heavy penalties and that the levy of such taxes will constitute a lien upon its property and thereby a cloud upon its title thereto, and that plaintiff will suffer other and irreparable damage, etc., all of which will appear by reference to the allegations set out in its bill herein. The plaintiff's seeking an injunction, restraining defendants in the discharge of their official duties imposed by the Statute is based upon the allegation that the sections of the Revenue Act of 1921, and especially upon the sections known as the "Income Tax Act" violate the Constitution of the State of North Carolina and of the United States for that and other reasons:

1st. The tax levied as directed by said Statute is not a tax on incomes but is levied upon gross income, or real net operating income and hence is repugnant to the State Constitution and to the Commerce Clause of the Federal Constitution.

2nd. The classification made by Section 202 of the Act as a method of ascertainment of net income for plaintiff and other corporations within the designed class is arbitrary, without reasonable or practical basis and hence is repugnant to the Uniformity Clause Art. 5, Sec. 3 of the State Constitution and the Equal Protection

Clause of the Fourteenth Amendment to the Constitution of the United States.

That it is a violation of the State Constitution for the general property tax to be devoted to local purposes and the various excise, privilege, franchise, license and income taxes to be devoted to State purposes.

That the income tax is invalid because it is levied in addition to property and franchise taxes. That the method of ascertaining the taxable income of plaintiff fixed or prescribed by Section 202 of the Act violates the provisions of Art. 5, Sec. 3 of the State Constitution and of the Fourteenth Amendment to the Federal Constitution, in that such method is not applied to such railroads or other public service corporation which do not operate their properties but have income only from rentals paid them by other companies to whom they lease their entire properties to be operated by the lessees.

It is pertinent, in view of the questions presented by the bills and answers and the prayer for injunctive relief to note the provisions of Section 700-701 of the Income Tax Act as amended by the Act of 1921 creating the office known as Commissioner of Revenue, providing for and prescribing the procedure in applications for review and appeal from assessments and levies of taxes against all persons or corporations having property in, or being liable for, tax in the State.

The Legislature, at its Special Session of 1921, made further provisions for refunding any taxes of any kind which have been through clerical error or misinterpretation or otherwise, collected or paid into

the State Treasury in excess of the amount legally due to the State and directing the State Auditor to issue his warrant for the amount so illegally collected to the person entitled thereto upon certificate of the head of the department through which the taxes were collected or his successor in the performance of the functions of that department, with the approval of the Attorney General and the Treasurer to pay the sum out of any funds in the treasury not otherwise appropriated.

Upon consideration of the bill and answer Exhibits and evidence it is

Adjudged and decreed that plaintiff is not entitled to have the defendants or either of them enjoined and restrained from the performance of the duties imposed upon them by the Statutes of North Carolina relating to the administration, assessing, levying and enforcement or collection of the income tax against plaintiff. The

the bill be dismissed. That defendants recover their cost to be taxed by the Clerk.

This the 7th day of November, 1922.  
Wilson, North Carolina.

H. G. CONNOR,  
*U. S. District Judge*

*Notice of Appeal.*

Filed Nov. 16, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

**In Equity.**

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,  
Defendants.

*Notice of Appeal.*

to the defendants in the above-entitled action and Honorable James S. Manning, Attorney General of North Carolina, and Frank Nash, Assistant Attorney General, Solicitors for defendants:

You will please take notice that, on Friday, November 17th, 1922, 10.00 o'clock A. M., or as soon thereafter as counsel may be heard, the above named plaintiff will apply to his Honor, Henry G. Connor, District Judge, at the United States Court Room, Wilmington, N. C., for an order allowing plaintiff to appeal to the Supreme Court of the United States in the above cause and granting a stay of proceedings until the appeal shall have been heard, passed upon and disposed of by the Supreme Court of the United States.

SEABOARD AIR LINE RAILWAY  
COMPANY,  
By MURRAY ALLEN,  
*Solicitor.*

Service accepted this 16 day of November, 1922.

JAMES S. MANNING,  
*Attorney General of North Carolina  
and Solicitor for Defendants.*

122

*Order Granting Thirty Day Stay.*

Filed Nov. 18th, 1922.

In the District Court of the United States for the Eastern District  
North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, as Commissioner of Revenue of North Carolina, and  
Others.

Income Tax Suit.

It is ordered that the defendants shall not proceed to enforce the collection of taxes involved in this litigation for the period of thirty days from the date of this order, to the end that complainant may take such action in the premises as it is advised to.

Dated at Wilmington, North Carolina this the 17th day of  
November, 1922.

H. G. CONNOR,  
U. S. Judge.

123

*Assignments of Error.*

Filed Nov. 27, 1922.

In the District Court of the United States for the Eastern District  
North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.  
Defendants.

Now comes the plaintiff in the above entitled cause and, in connection with its petition for appeal from the decree entered November 15th, 1922, denying the application for a permanent injunction, files the following assignments of error:

The Court erred:

1. In decreeing that, upon consideration of the bill and answer, exhibits and evidence, plaintiff is not entitled to have the defendants or either of them enjoined and restrained from the performances of the duties imposed upon them by the statutes of North Carolina relating to the administration, assessing, levying and enforcement or collection of the income tax against the plaintiff.

2. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because said act is in violation of the Constitution of North Carolina and the Constitution of the United States, creates a discrimination against plaintiff and other railroad companies or similar character in favor of other corporations and individuals in that the said act in order to ascertain the taxable income allows other corporations and individuals certain deductions, many of which said deductions are not allowed to plaintiff and other railroad corporations of similar character.

3. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because, under the provisions of the Income Tax Act of 1921, and particularly Section 202, Section 300, and Section 306, all corporations which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, are required to pay a tax on their net income, which is defined by Section 300 as "the gross income of a taxpayer, less the deductions allowed by this act," whereas plaintiff and other railroads and public service corporations which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, are required to pay a tax on their net income, which is defined by Section 300 as "the gross income of a taxpayer, less the deductions allowed by this act," whereas plaintiff and other railroads and public service corporations which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, are not allowed the deductions set forth in the said act, except "uncollectible revenue" and taxes paid in the State for the income year other than income taxes, war profits and excess profits taxes, and certain deductions for car hire, and plaintiff and other railroad companies and public service corporations of similar character referred to in Section 202 of the Income Tax Act of 1921 are denied large deductions which are granted other corporations, individuals and railroads not included in the provisions of Section 202, and particularly the deduction of interest paid during the income year, which results in discrimination against the plaintiff, in violation of the Constitution of North Carolina, and denies the plaintiff the equal protection of the law and deprives it of its

property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

4. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax  
125 attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because said act does not operate equally and uniformly upon all taxpayers in similar circumstances, and that the plaintiff and other railroads and public service corporations, which are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, have been arbitrarily selected and taxed upon a more burdensome basis and one that is different from that applied to corporations in general and to other corporations engaged in business similar to that of plaintiff, in violation of the Constitution of North Carolina and plaintiff is thereby denied the equal protection of the law and is deprived of its property without due process of law in contravention of the Fourteenth Amendment of the Constitution of the United States.

5. In failing to hold that the plaintiff is entitled to an injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because said tax is not levied by a uniform rule as required by the Constitution of North Carolina, Article 5, Section 3, and the lack of uniformity works greatly to the detriment of plaintiff, in violation of said Article 5, Section 3, of the Constitution of North Carolina, and denies the plaintiff the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment of the Constitution of the United States.

6. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because the classification of taxpayers for the purpose of fixing the income on which the tax shall be paid as made by the said Income Tax Act of 1921 is not based upon any reasonable ground, but is a mere arbitrary selection so far as plaintiff and railroad companies of similar character are concerned and so far as the corporations set forth in Section 202 are concerned, and was made for the purpose and has the result of imposing upon such railroad companies and corporations, including  
126 plaintiff, and unjust burden of taxation, in violation of the Constitution of North Carolina and denies the plaintiff the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment of the Constitution of the United States.

7. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void, because the

method of fixing plaintiff's taxable income as provided by Section 202 of the said Income Tax Act of 1921 violates the Constitution of North Carolina and the Constitution of the United States because it does not apply to railroads and public service corporations which derive their income from sources other than the operation of their property, which results in a lack of uniformity in the application of the income tax and in discrimination against plaintiff, and therein denies the plaintiff the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment of the Constitution of the United States.

8. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void, because the authority of the Legislature of North Carolina to tax incomes is derived from Section 3, Article 5. of the Constitution of North Carolina, and said section provides that only net incomes may be taxed, and in attempting to tax the "operating revenues" of plaintiff, the said act violates the Constitution of North Carolina and denies the plaintiff the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment of the Constitution of the United States.

9. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because said act is violative of Article 5, Section 3, of the Constitution of North Carolina, for that it does not levy upon railroads and other public service corporations named in said Section 202, a tax on net income, but levies a tax upon operating revenue derived from interstate and intrastate commerce, and does not permit the deductions necessary and incidental to the business of plaintiff and expended by it from said income in order to determine net income, and is in violation of the Interstate Commerce Clause, (Section 8, Article 1) of the Constitution of the United States, in that it permits a tax as an income tax to be placed on gross income derived from interstate commerce, thereby burdening interstate commerce.

10. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because said act violates the Transportation Act of Congress and the Interstate Commerce Act, in that it seeks to prescribe a method of accounting by this interstate carrier, when said Acts of Congress have delegated the power to prescribe said accounting to the Interstate Commerce Commission and the said Commission has prescribed and directed that this plaintiff and other interstate carriers keep their accounts in accordance with the methods so prescribed by it.



11. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because the

State of North Carolina, by its tax laws, permits the counties,  
128 cities, towns, townships and special taxing districts to levy taxes on the assessed value of plaintiff's property known as an ad valorem tax, which is based upon the whole property of plaintiff, tangible, and to this the tax laws of the State add a so-called franchise tax of one-tenth of one per cent on the same assessed value, and by the statutes hereinbefore referred to, the Legislature of North Carolina has levied and unless restrained the defendants in this action will undertake to collect an additional tax characterized as an income tax of three per cent on plaintiff's net operating revenue, including revenue derived from interstate commerce, and plaintiff avers that this system of pyramiding taxes and the entire scheme of taxation amounts to a regulation of commerce between the States, because necessarily a tax of one-tenth of one per cent upon the tangible and intangible property of this plaintiff and a tax of three per cent upon its net operating revenue, including revenue derived from interstate commerce, are taxes upon interstate commerce the property, tangible and intangible, having already been taxed at its full value and plaintiff shows that this scheme of taxation levies a tax and burden upon the interstate commerce of plaintiff and violates the Commerce Clause of the Constitution of the United States, Section 8 of Article 1.

12. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because the penalties imposed for failure to comply with the Income Tax Act enacted by the Legislature of North Carolina are so excessive as to be violative of plaintiff's rights under the Constitution of the United States.

13. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void because  
129 the plaintiff has no adequate remedy at law.

14. In failing to hold that the plaintiff is entitled to the injunction as prayed for in the bill of complaint, for that the income tax attempted to be imposed upon plaintiff by the Income Tax Act of 1921 enacted by the Legislature of North Carolina is void for that the levy of the income tax casts a cloud upon plaintiff's title.

MURRAY ALLEN,  
*Solicitor for Plaintiff.*



*Stipulation of Counsel as to Record.*

Filed Dec. 5, 1922.

In the District Court of the United States for the Eastern District  
of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,  
Defendants.*Stipulation of Counsel as to Record.*It is stipulated and agreed by and between the parties to the above  
entitled cause:That the Clerk, in making up the transcript of record on this ap-  
peal from the decree of the District Court shall include:

Bill of complaint and exhibits.

Application for interlocutory injunction.

Order on application for interlocutory injunction.

Notice of hearing on application for interlocutory injunction.

Answer.

Affidavit of J. H. Bridgers with exhibits.

Affidavit of Nathan O'Berry.

Affidavit of C. D. Bradham.

Affidavit of A. R. Turnbull.

Affidavit of J. C. Nelms.

Affidavit of J. C. Nelms.

Affidavit of J. C. Nelms.

Affidavit of F. C. Harding.

Affidavit of W. H. McKenzie.

Affidavit of W. L. Stanly.

Affidavit of M. S. Hawkins.

Affidavit of E. H. Kemper.

Affidavit of O. S. Thompson.

Affidavit of A. J. Maxwell.

Affidavit of R. O. Self.

Testimony and exhibits.

Certificate of Corporation Commission as to certain lumber corpo-  
rations, and others licensed as common carriers and engaged in in-  
terstate commerce in North Carolina.

Notice of appeal.

Petition for appeal.

Assignments of error.

Order allowing appeal and granting supersedeas and stay Bond and Citation.

Decree.

Stipulation of counsel.

It is further stipulated that the Clerk may use in preparing the record on appeal printed copies of all such pleadings, documents, affidavits, etc., as may be furnished by the parties hereto.

MURRAY ALLEN,  
*Solicitor for Complainant.*  
GEO. H. BROWN,  
*Of Counsel for Defendants.*

131 *Memorandum of Original Papers Certified Separately.*

Petition for Appeal filed November 27th, 1922.

Appeal allowed November 27, 1922.

Appeal Bond dated Dec. 7, 1922; penalty, \$1,000.00; Obligors Seaboard Air Line Railway Company and Royal Indemnity Company: Conditioned for damages and costs.

Citation dated Nov. 27, 1922; service accepted by George H. Brown, of Counsel for Defendants, Nov. 27th, 1922.

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*Order to Transmit Record.*

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

#447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als.

And thereupon it is ordered by the Court here that a transcript of the record and proceedings in said suit be transmitted to the United States Supreme Court at Washington, D. C., and the same be transmitted accordingly.

S. A. ASHE,  
*Clerk United States District Court.*

*Clerk's Certificate.*

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als

I, S. A. Ashe, Clerk, United States District Court, for the Eastern District of North Carolina, do hereby certify that the foregoing pages present a full, true and correct copy of the proceedings had and orders entered in that certain suit in equity pending in said Court, wherein Seaboard Air Line Railway Company is complainant and A. D. Watts, Commissioner of Revenue of North Carolina, and others, are Defendants.

In testimony whereof, I have hereunto set my hand and affixed the seal of the said District Court at the Courthouse in Raleigh, State of North Carolina, this 16 day of December, 1922.

[Seal United States District Court, Eastern Dist. of N. C. at Raleigh.]

S. A. ASHE,

*Clerk United States District Court.*

11 & 135 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiff.

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et als.,  
Defendants.

*Petition for Appeal and Stay.*

to the Honorable H. G. Connor, District Judge of the United States for the Eastern District of North Carolina:

The Seaboard Air Line Railway Company, the above named plaintiff, feeling aggrieved by the order of the Court entered in the above entitled cause on the 13th day of November, 1922, refusing and deny-

ing the injunction applied for in this cause restraining the defendants from collecting the income tax assessed against the plaintiff, hereby appeals to the Supreme Court of the United States from the said order upon the grounds set forth in the assignments of error filed herewith, and plaintiff prays that its appeal be allowed and that citation be issued as provided by law and that a transcript of the record, proceedings and documents, upon which said appeal is based, duly authenticated, be sent to the Supreme Court of the United States under the rules of such Court in such cases made and provided.

And plaintiff further prays that the Court enter an order staying the collection of the said income tax and staying further proceedings by the defendants until the appeal herein prayed for shall have been heard, passed upon and disposed of by the Supreme Court of the United States.

SEABOARD AIR LINE RAILWAY  
COMPANY,  
By MURRAY ALLEN,  
*Solicitor.*

136 [Endorsed:] No. 447. Eq. Seaboard Air Line Railway Company, Plaintiff, vs. A. D. Watts, Commissioner of Revenue of North Carolina, et als., Defendants. Petition for Appeal and Stay. Murray Allen, Attorney at Law, 709-711 Citizens National Bank Building. I certify that the within is entered and filed this day, Nov. 27, 1922. S. A. Ashe, Clerk.

137 & 138 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.  
Defendants.

*Order Allowing Appeal and Granting Supersedeas and Stay.*

This cause coming on to be heard upon the application of complainant, Seaboard Air Line Railway Company, for an appeal to the Supreme Court of the United States, and for a supersedeas and order staying and restraining the collection of the income tax involved in this suit and alleged to be illegal in the complaint filed herein, until the determination of the appeal in this cause now pending in the Supreme Court of the United States, and complainant being represented by Murray Allen, its attorney, and the defendants by their attorneys, Frank Nash, Assistant Attorney General of North Carolina

and George H. Brown, the appeal prayed for is hereby granted, Appeal Bond in the sum of \$1,000.00 to be filed.

And the Court being of the opinion that the status quo between the parties should be preserved pending such determination of appeal by the complainant to the Supreme Court of the United States:

It is, therefore, decreed and adjudged that defendants, their agents, servants and employees and each of them be and are hereby restrained from collecting or attempting to collect from complainant the income tax which is the subject matter of this suit, pending the determination of the appeal by the complainant in this cause now pending in the United States Supreme Court.

It is further ordered and decree that complainant do give bond, with good and sufficient surety, in the sum of \$10,000.00, to be approved by the Judge of the United States Court, or the Clerk of said Court, conditioned to pay to said defendants all of such income tax that may finally be determined in this cause to be legally due and payable by the complainant to the defendants.

Dated this 27th day of November, 1922.

H. G. CONNOR,

*District Judge Eastern District of North Carolina.*

139 [Endorsed:] (J.) No. 477. Eq. Seaboard Air Line Railway Co. vs. A. D. Watts, Commissioner of Revenue, et al. Order Allowing Appeal & Granting Supersedeas & Stay under \$10,000 Bond. I certify that the within is entered and filed this day, Nov. 27, 1922. S. A. Ashe, Clerk.

140 In the District Court of the United States for the Eastern District of North Carolina.

SEABOARD AIR LINE RAILWAY COMPANY

vs.

A. D. WATTS et als.

Know all men by these presents: That Seaboard Air Line Railway Company, as principal, and Royal Indemnity Company, as surety, acknowledge themselves indebted to the defendants, A. D. Watts, Commissioner of Revenue of North Carolina, Benjamin R. Lacy, State Treasurer of North Carolina, Baxter Durham, State Auditor of North Carolina, and James S. Manning, Attorney General of North Carolina, in the above entitled cause in the sum of One Thousand (\$1,000.00) Dollars, to the payment of which we bind ourselves, our successors and assigns.

In witness whereof, Seaboard Air Line Railway Company, principal, has caused these presents to be executed by M. J. Caples, one of its vice-presidents, its corporate seal to be hereto affixed, and attested by T. W. Mathews, one of its assistant secretaries, and Royal Indemnity Company, the surety, has caused these presents to be executed by S. E. Haynes, its Attorney in Fact, duly appointed and

authorized to execute surety bonds, and its corporate seal to be hereto affixed.

The condition of the foregoing bond is such that:

Whereas, Seaboard Air Line Railway Company, the above named plaintiff, instituted a suit in the United States District Court for the Eastern District of North Carolina against A. D. Watts, and other defendants named in said bill, in which said cause a permanent injunction was asked to be granted against the defendants, enjoining the collection of the income tax claimed to be due the State of North Carolina as set out in said bill upon the grounds as set forth in said bill; and,

Whereas, upon the hearing of said application for a permanent injunction, the prayer of the plaintiff was denied and the bill dismissed; and,

Whereas, the plaintiff has obtained an appeal to the Supreme Court of the United States and a citation has been issued to the defendants citing and admonishing them to be and appear in the Supreme Court of the United States on December 27th, 1922:

Now, the condition of the above obligation is such that, if the said Seaboard Air Line Railway Company shall prosecute its appeal to effect and answer all damages and costs if it fail to make its plea good, then the above obligation to be void; else to remain in full force and effect.

In witness whereof, Seaboard Air Line Railway Company, principal, has caused these presents to be executed by M. J. Caples, one of its vice-presidents, its corporate seal to be hereto affixed, and attested by T. W. Mathews, one of its assistant secretaries, and Royal Indemnity Company, surety, has caused these presents to be executed by S. E. Haynes its Attorney in Fact, thereunto duly authorized and empowered so to do, and its corporate seal to be hereto affixed, this the 7th day of December, 1922.

SEABOARD AIR LINE RAILWAY  
COMPANY,

By M. J. CAPLES,  
*Vice-President.*

Attest:

[Seal of the Seaboard Air Line Railway Company.]

T. W. MATHEWS,  
*Assistant Secretary.*

[Seal of the Royal Indemnity Company.]

ROYAL INDEMNITY COMPANY,  
By S. E. HAYNES,  
*Attorney in Fact.*

Approved:

H. G. CONNOR,  
*Judge of the United States  
District Court for the Eastern  
District of North Carolina.*

143 [Endorsed:] #447. Eq. Seaboard Air Line Railway Company vs. A. D. Wats et als. Appeal Bond. Murray Allen, Attorney at Law, 709-711 Citizens National Bank Building, Raleigh, N. C. I certify that the within is entered and filed this day, Dec. 13, 1922. S. A. Ashe, Clerk.

144 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 447.

SEABOARD AIR LINE RAILWAY COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina; BENJAMIN R. LACY, State Treasurer of North Carolina; Baxter Durham, State Auditor of North Carolina, and James S. Manning, Attorney General of North Carolina, Defendants.

The United States of America to A. D. Watts, Commissioner of Revenue of North Carolina; Benjamin R. Lacy, State Treasurer of North Carolina; Baxter Durham, State Auditor of North Carolina, and James S. Manning, Attorney General of North Carolina, Greeting:

Whereas, Seaboard Air Line Railway Company has lately appealed to the Supreme Court of the United States, from a decree lately rendered in the District Court of the United States for the Eastern District of North Carolina, made in favor of you, the said Seaboard Air Line Railway Company, having filed the security required by law, you are therefore hereby cited to appear before the said Supreme Court of the United States, at the City of Washington on the 27th day of December, next, to do and receive what may appertain to justice to be done in the premises.

Given under my hand at the City of Raleigh in the Fourth Circuit, this the 27th day of November, in the year of our Lord, One Thousand Nine Hundred and Twenty-two.

H. G. CONNOR,

*Judge of the District Court of the United States for the Eastern District of North Carolina.*

I certify that the within is entered and filed this day Nov. 27, 1922.

S. A. ASHE,

*Clerk.*

Service accepted this November 27th, 1922.

GEO. H. BROWN,  
*Of Counsel for Defendants.*

145 [Endorsed:] #447. Eq. Seaboard Air Line Railway Company vs. A. D. Watts et al. Citation & Acceptance of Service. I certify that the within is entered and filed this day, Nov. 27, 1922. S. A. Ashe, Clerk.

Endorsed on cover: File No. 29,294. E. North Carolina D. C. U. S. Term No. 744. Seaboard Air Line Railway Company, appellant, vs. A. D. Watts and A. D. Watts, as Commissioner of Revenue of the State of North Carolina, et al. Filed December 18th, 1922. File No. 29,294.

(8267)

A.

For  
JAN